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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-590

D. B. ANDERS,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

J. GLENN HAHN
1100 Commerce Bank Building
Kansas City, Missouri 64106
Counsel for Petitioner

Of Counsel:
HARLOW B. KING
WALTER J. KENNEDY
1100 Commerce Bank Building
Kansas City, Missouri 64106

E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, 421-3030

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in the above-entitled case on July 14, 1972.

CITATION TO OPINION BELOW

The opinion of the United States Court of Claims, printed in Appendix A-1 hereto, *infra*, p. A1, is reported in ..... F.2d ..... (72-2 USTC Par. 9561) (Docket No. 35-71, July 14, 1972).

JURISDICTION

The judgment of the United States Court of Claims was dated and entered July 14, 1972. The jurisdiction of this court is invoked under 28 U.S.C. Sec. 1255(1). The jurisdiction of the United States Court of Claims was based on 28 U.S.C. Sec. 1491 and 26 U.S.C. Sec. 7422 as an action on a claim for refund of income taxes.

QUESTION PRESENTED

Whether the United States Court of Claims erred in granting respondent's motion for summary judgment and dismissing petitioner's petition where:

(1) The Court of Claims did not find that there was no genuine issue of material fact to be tried, but nonetheless proceeded to consider the case on its merits, when in fact a genuine issue of material fact does exist;

(2) In granting respondent's motion the Court of Claims placed upon petitioner the burden of setting forth specific facts showing that there was a genuine issue of material fact to be tried, although respondent as the moving party had filed no affidavits or otherwise come within the provisions of Rule 101(f) and should have been required to establish the absence of any material fact to be tried; and

(3) The Court of Claims held that the "tax-benefit rule" is an unwritten exception to Section 337 of the Internal Revenue Code, 26 U.S.C. Sec. 337.

STATUTE, REGULATION AND RULES INVOLVED

The statutory provisions involved are Secs. 337(a), (b) and (c) of the Internal Revenue Code of 1954, 26 U.S.C. Secs. 337(a), (b) and (c), 68 A Stat. at p. 106. Said statutory provisions are set forth in Appendix B-1, *infra*, p. A6.

The regulation involved is U.S. Treas. Reg. Sec. 1.337-3(a), 26 CFR Sec. 1.337-3(a), p. 69. Such regulation is set forth in Appendix B-2, *infra*, p. A8.

The rules involved are United States Court of Claims Rules 101(d) and 101(f). Such rules are set forth in Appendix B-3, *infra*, p. A9.

STATEMENT OF CASE

Petitioner as plaintiff below commenced this action in the United States Court of Claims under 28 U.S.C. Sec. 1491 and 26 U.S.C. Sec. 7422, pursuant to a timely claim for refund of Federal income taxes in the amount of $60,839.60 for the taxable year ended July 31, 1961, paid by petitioner as transferee of the assets of D. B. Anders, Inc., a Missouri corporation.

The petition, a true, complete and correct copy of which is set forth as Appendix C-1 hereto, *infra*, p. A11, was duly filed on or about February 4, 1971. Respondent as defendant below duly filed its Answer, a true, complete and correct copy of which is set forth as Appendix C-2 hereto, *infra*, p. A20, on or about June 4, 1971.

On or about June 7, 1971, Mastin G. White, Commissioner, United States Court of Claims, to whom the case had been assigned, issued Standard Pretrial Order on Liability (Rule 111), a true, complete, and correct copy of which is set forth as Appendix D-1 hereto, *infra*, p. A22. On or about August 5, 1971, petitioner duly filed and served on respondent Plaintiff's Submission to Standard Pretrial Order (Rule 111), a true and correct copy of which is set forth as Appendix D-2 hereto, *infra*, p. A26. By motions duly filed September 23, 1971 and November 8, 1971 respondent obtained extensions of time to December 7, 1971, within which to file its response as required by the aforesaid Pretrial Order of June 7, 1971. On or about December 7, 1971, respondent filed a third motion, requesting a further extension of time to December 22, 1971, within which "to file its motion for summary judgment and brief in support thereof in lieu of defendant's responsive submission under the Pretrial Order of June 7, 1971," which motion was

granted. On or about December 21, 1971 respondent filed its Motion of the United States for Summary Judgment and Brief in Support Thereof, a true, correct, and complete copy of which is set forth as Appendix E-1 hereto, *infra*, p. A35. On or about February 5, 1972, petitioner filed its Plaintiff's Response to Defendant's Motion for Summary Judgment and Supporting Brief; a true, correct, and complete copy of which is set forth as Appendix E-2 hereto, *infra*, p. A52. On or about March 23, 1972, respondent filed its Reply Brief, a true, correct and complete copy of which is set forth as Appendix E-3 hereto, *infra*, p. A85.

On or about September 24, 1971, respondent by letter addressed to petitioner requested that petitioner furnish respondent with copies of the documents numbered 4 to 11 in Plaintiff's Submission to Standard Pretrial Order, Appendix D-2, *infra*, p. A27 and with copies of the Federal income tax returns of D. B. Anders, Inc., the transferor corporation, for the taxable years ended July 31, 1957, 1958, 1959, and 1960. The aforesaid documents numbered 4 to 11 and the Federal income tax return of the transferor corporation for the taxable year ended July 31, 1960, were furnished by petitioner to respondent on or about October 6, 1971, the returns for the earlier years being unavailable. At no time did respondent file any response as required by paragraph 2 of the Standard Pretrial Order on Liability, Appendix D-1, *infra*, pp. A23-A24. Respondent filed no affidavits or any other documents in support of his Motion for Summary Judgment, either before or after the filing of said Motion for Summary Judgment. The aforesaid documents numbered 4 to 11, *supra*, were not filed with the Court.

The pleadings and plaintiff's pretrial submission established that the transferor corporation, *D. B. Anders, Inc.*

had been engaged in the industrial laundry business in Kansas City, Missouri, providing a rental service of shirts, pants, jackets, and other garments, clean and laundered towels, seat covers, fender covers, and various wiping materials, hereinafter referred to as "rental items." For income tax purposes the corporation deducted the cost of the rental items used in conducting its industrial laundry business at the time such items were placed into use.

In May, 1961 the transferor corporation adopted a plan of complete liquidation pursuant to Section 337 of the Internal Revenue Code of 1954, and sold all of its properties, including the properties used in the conduct of its rental business, to one purchaser in one transaction. On its income tax return for the taxable year ended July 31, 1961, the corporation reported a gain in the amount of $163,002.24 arising out of the aforesaid sale and claimed the exclusion of such gain under Section 337. The gain included the sum of $117,000, which was the portion of the total contract price allocated to the properties in use in its rental business. The respondent's assertion was that the gain on the sale of these properties was not exempt under Section 337 because the cost thereof had been previously expensed. The record before the Court did not establish the total amount paid or incurred by the transferor corporation during its taxable year ended July 31, 1961, for the purchase of rental items, the cost of such items placed into use during said taxable year, the inventory of the rental items on hand at the date of the sale, or the original cost thereof.

Defendant's Motion for Summary Judgment was argued before the Court of Claims in Washington, D. C. on May 3, 1972. So far as petitioner is aware no transcript exists of these proceedings. Respondent adduced no evidence at the hearing. During petitioner's argument the

Court[1] stated that by filing its motion for summary judgment therein, respondent had shifted to the petitioner the burden of coming forward with the evidence to show that there was a material and genuine issue of triable fact.

On or about July 14, 1972, the Court of Claims entered its opinion granting respondent's motion for summary judgment and dismissing the petition, apparently relying principally upon *Spitalny* v. *United States*, 430 F.2d 195 (9th Cir. 1970), all as set forth in its opinion of that date, a true, complete, and correct copy of which is set forth as Appendix A-1, *infra*, pp. A1-A5.

Petitioner timely filed the instant petition for writ of certiorari.

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1. It is the recollection of petitioner's counsel that such comment was made by the Honorable Judge Kunzig, who wrote the Court's opinion in the instant case.

REASONS FOR GRANTING THE WRIT

I. Interpretation and Application of Rule 101

The procedural question presented, whether the Court of Claims properly interpreted and applied Rule 101 in granting respondent's motion for summary judgment is of major importance in connection with all suits for refund of Federal income taxes, not only in the United States Court of Claims, but also in all United States District Courts, since Rule 56, Federal Rules of Civil Procedure is substantially identical to Rule 101.

A. The Court of Claims Improperly Failed to Determine That Material and Genuine Issues of Triable Fact Exist.

The Court of Claims did not properly exercise its function in its consideration of the motion before it. On a motion for summary judgment the court cannot try issues of fact. It can only determine whether there are issues to be tried. 3 Barron & Holtzoff, *Federal Practice and Procedure* §1231 at p. 101 (2d ed. 1958). The question to be decided on such a motion is *whether* there is a genuine issue of fact and not *how* that issue should be determined. *Ibid.* §1234 at p. 122. In the instant case there was no finding by the Court of Claims that there was an absence of a genuine issue of material fact to be tried. Indeed, there is not even any discussion of the burden of proof. Instead, the court purported to make findings of fact and proceeded to try the case on its merits while sitting as an appellate forum.

This was reversible error. From the opinion of the Ninth Circuit Court of Appeals in *Spitalny* v. *United States*, 430 F.2d 195 (9th Cir. 1970), upon which the Court of Claims ostensibly relied, it is clear that it was essential for the trial court to make findings of fact as to each of the following:

> (1) The total costs paid or incurred by the transferor corporation during its taxable year ended July 31, 1961, for the purchase of the rental items;
>
> (2) The total costs of such items placed in use by the corporation during said taxable year;
>
> (3) The inventory of such items at the date of the sale to the purchaser and the original cost thereof; and
>
> (4) The amount of the total sales price allocated to the rental items.

Indeed, the *Spitalny* case was reversed and remanded to the lower court with these comments:

> "We conclude that the District Court . . . erred in holding the *entire* sales price of the feed on hand to be nonrecognized gain under §337.
>
> "One difficulty remains. It cannot be ascertained from the present record what the cost (and the basis) of this feed was. If the feed was sold in liquidation at a greater figure than cost *the sales price does to that extent represent gain which would be nonrecognizable under §337. In our view appellees should have the opportunity to establish the facts in this respect.*" 430 F.2d 195 at 198 (*italics added*).

The Court of Claims in the case below made no finding with respect to the first three items above. There was

no record from which it could make such findings. If the original cost of the rental items sold was less than $117,000, then any excess of the sales price over such cost would be "nonrecognized gain under §337." There were genuine and material issues of triable fact; the court below erred in failing so to determine.

B. The Court of Claims Improperly Interpreted Rule 101(f) by Its Assumption That the Burden of Proof Was Shifted to Petitioner.

As the moving party respondent clearly had the burden of showing *the absence* of a genuine issue as to any material fact. *Adicker* v. *Kress & Co.*, 398 U.S. 144 (1970). This rule applies, even though plaintiff would have the burden of proving the facts at trial. *Sheridan* v. *Garrison*, 415 F.2d 699 (5th Cir. 1969). For the purposes of determining whether the moving party has met its burden, the material it lodges must be viewed in the light most favorable to the opposing party. *Adicker* v. *Kress & Co.*, *supra*.

Rule 101(f) provides as follows:

> "(f) Form of Affidavits; Further Testimony: Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented

or opposed by depositions or by further affidavits.[2] When a motion for summary judgment is made *and supported as provided in this rule*, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, will be entered against him." (*italics added*).

Respondent filed no affidavits at any time in the court below. It filed no response as required by the Standard Pretrial Order on Liability as entered by the Court on June 7, 1971. Indeed, respondent filed nothing but its Answer, Appendix C-2, *infra*, p. A20, and its Motion for Summary Judgment and Brief in Support Thereof, Appendix E-1, *infra*, pp. A35-A42. Petitioner filed *no* cross-motion for summary judgment. Under Rule 101(f) it is only "when a motion for summary judgment is made *and supported as provided in this rule*," (*italics added*) *i.e.*, by the filing of sworn affidavits, depositions or by further affidavits, that "an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." Respondent's motion for summary judgment was not supported by affidavits or otherwise as required by Rule 101(f). There are genuine material issues of triable fact, as set forth above. Respond-

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2. Rule 56(e) Federal Rules of Civil Procedure, is identical to Rule 101(f) except that this sentence reads, "The court may permit affidavits to be supplemented or opposed by depositions, *answers to interrogatories* or further affidavits." (*italics added*).

ent did not establish the absence of these issues; it and the court simply ignored them. Further, the court's comments at the hearing make it clear that the case was decided upon the erroneous premise that by the mere filing of its motion, respondent had shifted to petitioner the burden of showing the presence of a triable issue of material fact, despite the fact that respondent's motion was unsupported in any way. This is not the law; it cannot be. If it were, the respondent could require every taxpayer to try his tax refund case on a motion for summary judgment by the simple expedient of filing such a motion, unsupported by affidavits or otherwise. It would render meaningless the words in Rule 101(f), *"and supported as provided in this rule."*

In sustaining his burden on a motion for summary judgment, the moving party *positively and clearly* must demonstrate that there is no genuine issue of fact, and any doubt as to the existence of such issue must be resolved against the moving party. The party opposing summary judgment does *not* have the burden of showing that there is a genuine issue for trial until the movant has produced evidentiary material showing that there is no genuine issue as to any material fact and he is entitled to judgment as a matter of law. *2361 State Corp.* v. *Sealy, Inc.*, 402 F.2d 370 (7th Cir. 1968). The trial court erred in determining the case below upon the premise that the burden of showing that there is a genuine issue for trial had shifted to petitioner under Rule 101(f) when respondent filed no sworn affidavits or depositions in support of its motion for summary judgment.

II. The Holding of the Court of Claims on the Legal Issue Patently Thwarts the Clearly Expressed Congressional Intent in Enacting Section 337 of the Internal Revenue Code of 1954.

Seldom has a legislative body so clearly expressed its intent as in the enactment of Section 337 of the 1954 Internal Revenue Code. And even more rarely have the courts been permitted to thwart such clearly expressed legislative intent by rhetorical artifice. Yet this is the inescapable result of the holding of the court below on the substantative issue of law.

There can be no reasonable doubt as to the Congressional purpose in the enactment of Section 337. The House Report is explicit:

> "Section 333[3] incorporates in the bill rules for treatment of the problem raised in the decisions of Commissioner v. Court Holding Company (324 U.S. 331, 65 S.Ct. 707) and U. S. v. Cumberland Public Service Co. (338 U.S. 451, 70 S.Ct. 280) and the numerous related cases. These decisions concern the question of whether the corporation or a shareholder effected a sale of property in connection with a liquidation. Under the decision in the Cumberland Public Service Co. case, supra, it is indicated that in the case of an actual distribution in liquidation of the corporation prior to an actual sale by the shareholders a single tax [is] imposed at the shareholder level. Accordingly, under present law, the tax consequences arising from sales made in the course of liquidation depend primarily upon the formal manner in which transactions are ar-

3. Section 337 in the Senate version, *infra*.

ranged. *The possibility that double taxation may occur in such cases results in causing the problem to be a trap for the unwary.*

"Your committee intends in section 333 to provide a definitive rule which will eliminate any uncertainty." H. Rep. No. 1337, 3 U.S. Code Cong. and Adm. News, 83d Cong., 2d Sess. 1954, 4025 at p. 4244 (*italics added*).

The Senate speaks with like clarity:

"Section 337 corresponds in function to section 333 of the House bill and concerns the problems raised by the decisions in Commissioner v. Court Holding Company, 324 U.S. 331, 65 S.Ct. 707, and U. S. v. Cumberland Public Service Co., 338 U.S. 451, 70 S.Ct. 280, and the numerous related cases. These decisions involve the question of whether the corporation or the shareholder effected a sale of property in connection with the liquidation of the corporation. Under the decision in Cumberland Public Service Co., supra, it is indicated that in the case of a distribution of property in liquidation of a corporation followed by its sale made in fact by its shareholders, a single tax is imposed at the shareholder level. Where the shareholders in fact did not effect the sale, tax is imposed both at the corporate and at the shareholder level. *Accordingly, under present law the tax consequences arising from sales made in the course of liquidations may depend primarily upon the formal manner in which the transactions are arranged. Your committee intends in section 337 to provide a definitive rule which will eliminate the present uncertainties. . . .*" S. Rep. No. 1622, *Ibid.* at p. 4896 (*italics added*).

But there can be no doubt that the result of the decision of the court below in following *Spitalny* v. *United States*, 430 F.2d 195 (9th Cir. 1970) and the related line of cases is to reinstate the uncertainties which Section 337 was designed to eliminate. As one writer has recently expressed it:

> "The recent decisions applying the tax benefit rule to the sales of assets under a plan of complete liquidation normally protected from recognition of gain or loss by section 337 will require careful tax planning to assure that unexpected income in substantial amounts is not recognized on such transactions."[4]

In considering methods of "avoiding recapture of prior deductions" under the tax benefit rule, the same writer goes on to state:

> ". . . it may be possible to arrange a sale of the property having recapture potential by shareholders following a liquidation distribution of the property in order to avoid recognition of income at the corporate level. . . . *First, the sale of the property by shareholders must not be attributed to the corporation under the familiar Court Holding Company doctrine. . . .*" *Ibid.* at p. 239 (*italics added*).

No clear mandate of analytical judicial persuasion led to this resurrection of the *Court Holding Company* problem under Section 337. To the contrary the judicial pathway has been one of strained construction, tortuous grammar, and pre-ordained conclusion, all artfully sewn to-

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4. O'Hare, "Statutory Nonrecognition of Income and the Overriding Principle of the Tax Benefit Rule in the Taxation of Corporations and Shareholders," 27 Tax L. Rev. 215, 238 (1972). This article is cited in its entirety by the court in the opinion below.

gether in the three years which have elapsed since the decision of the Tenth Circuit in *Commissioner* v. *Anders*,[5]

This legal issue under Section 337 was first considered judicially by the United States Tax Court in *D. B. Anders*, 48 T.C. 815 (1967), that court stating without equivocation that the application of the tax-benefit rule *"would contravene the clear and unambiguous provisions of section 337(a)...."* 48 T.C. at 821 (*italics added*). "If the result here is undesirable," the Tax Court went on, "the remedy is for Congress, not the courts." *Ibid.* at 823.

Approximately one year later the United States District Court for Arizona had before it *Spitalny* v. *United States*, 288 F.Supp. 650 (1968) which involved a similar legal issue under Section 337. The District Court there held that the tax-benefit rule was not an exception to Section 337, citing with approval the Tax Court's decision in *Anders* v. *Commissioner*, *supra*.

The decision of the Tax Court in *Anders* was reversed by the Tenth Circuit on appeal, 414 F.2d 1283 (10th Cir. 1969), *cert. denied*, 396 U.S. 958 (1969). The language of the Tenth Circuit's opinion mirrors its ordeal in arriving at its conclusion. This opinion was considered at length in Plaintiff's Response to Defendant's Motion For Summary Judgment and Supporting Brief herein[6]. Suffice it to say here that although that court was unable to determine with definity whether the rental items in question constituted "property" within the intendment of Section 337(a), or whether a "sale" of such property within

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5. Petitioner here was also there involved as transferee of the assets of D. B. Anders, Inc., a *Kansas* corporation. 414 F.2d 1283 (10th Cir.), *cert. denied*, 396 U.S. 958 (1969).

6. Appendix E-2, *infra*, p. A52.

the intendment of such Section had in fact occurred, and despite the Court's own admission that:

> "As the taxpayer says, the controversy is not clearly decided by any of these cases." 414 F.2d at 1288.

it was nonetheless able to conclude, "with little to guide it"[7] that:

> "In these circumstances we do not believe that treatment as a non-recognizable gain was intended by Congress." *Ibid.* at 1288-89.

In other words its conclusion was that Congress intended to *preserve* the uncertainty in those cases where a sale of property is effected in connection with a Section 337 liquidation. If the corporation sells certain types of property, the tax-benefit rule will cause the gain on the sale to be taxable to the corporation although it has adopted a Section 337 plan of liquidation, whereas if the corporation first liquidates and the shareholders sell the property, no gain to the corporation will result from the sale of such property. This is consistent with an express Congressional intent to *"eliminate any* uncertainty"?[8]

Perhaps the language of the Tenth Circuit's opinion in *Anders* was too purposeful even for the court below.[9] In any event it turned for its authority to the 1970 holding

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7. O'Hare, *op. cit. supra* n. 4 at 225.

8. In oral argument on his Motion for Summary Judgment, and in his Reply Brief, Appendix E-3, *infra*, respondent's counsel contended that if the corporation were first liquidated and the expensed property sold, the corporation would realize income on its final return ostensibly equal to the amount which the shareholders received on its subsequent sale. The authorities there cited by respondent obviously do *not* involve a liquidation followed by a stockholder sale. "We submit" hardly cures this discrepancy.

9. It was shunted aside as a "see" authority. As to "see," see Appendix E-2, *infra*, p. A70, n. 23.

of the Ninth Circuit in *Spitalny* v. *United States, supra* which followed the lead of *Anders* in reversing the lower court's decision at 288 F.Supp. 650. The *Spitalny* record clearly shows that the corporation had in its last taxable year prior to liquidation purchased feed and other supplies in the total amount of $607,968.02; that it maintained a memorandum inventory of feed and other supplies on hand; that at the time of the sale the corporation had on hand $177,437.37 of the feed and supplies purchased during the fiscal year, and that $177,437.37 of the total sales price of the assets was allocated to the feed and other supplies on hand.[10] The Commissioner argued in both the trial and the appellate court in *Spitalny* that what the Commissioner did was to disallow the expense deduction for purchase of feed in the year of sale to the extent of the sales price under Section 446(b) of the Internal Revenue Code and Section 1.162-3 of the Regulations. The appellate court sustained the Commissioner, holding that the distortion of income resulted from the taxpayer's accounting method.

Having done so, the court then proceeded to discuss the application of the "tax benefit rule" espoused by the Tenth Circuit in *Commissioner* v. *Anders, supra*. While candidly admitting that the "tax benefit rule" does not apply to a situation where costs are recovered in the same taxable year in which they were incurred, the court nevertheless went on to embrace *Anders* in patent dicta. "Struggling to avoid the logic of the syllogism of the Tax Court in *D. B. Anders*"[11] and perhaps unwilling to take refuge behind the nebulous distinctions drawn by the Tenth Circuit as to whether the property constituted "property" or a

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10. The court below in the instant case had before it only the amount allocated to the sales price of the rental items.

11. O'Hare, *op. cit. supra* n. 4 at 226.

"sale" was indeed a sale, the Ninth Circuit seized upon a new tack, was "gain" realized? Its predictable conclusion follows:

> "We agree that the feed and supplies on hand are 'property' under §337(b) and, accordingly, that 'gain' realized on their sale shall not be recognized. The crucial question, however, is whether 'gain' was realized. The assignment of a zero basis to expensed items is not in response to adjustments in valuation. It amounts, rather, to a present *fictional conversion* of that 'property' into a consumed item of expense. If the feed and supplies are to revert to 'property,' they should be reconverted. They should not at the same time be property and still retain attributes of a *fictional nonentity*." 430 F.2d at 198 (*italics added*).

This "fictional" philosophy appears to be the basis of the decision of the Court of Claims below:

> "We agree that both that the rental items are 'property' under Section 337(b)(1) and that the transfer to the buyer was a 'sale.' We further concur that if the 'gain' had been realized from the 'sale,' it should not have been recognized. However, we feel that the 'gain' was not realized from the 'sale,' but rather from *reconverting* the previously expensed items into 'property.' "[12]

What does "fiction" have to do with the tax law? There was no "*fictional expensing*" of the rental items; there was a "*factual expensing.*" There was no "*fictional reconversion*"; there was *no* "reconversion." Two fictions do not a fact make! How can the clearly expressed overt

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12. *I.e.*, the gain was realized from reversing the *fictional expensing* of the rental items. Appendix A-1, *infra*, p. A4 (*italics added*).

intent of Congress be overcome by this judicial legerdemain? If the Congressional intent was all this clear, would all this "fiction" be required?

The law as expressed by the Tenth Circuit in *Anders* and the Ninth Circuit in *Spitalny* is clearly wrong, a patent thwarting of the Congress. Yet it continues to spread its tentacles. The Court of Appeals triad is completed by the Third Circuit's decision in *Connery* v. *United States*, ... F.2d ..... (72-2 USTC Par. 9441) (May 22, 1972). The United States Tax Court has not abandoned its stand as set forth in the original *Anders* case; this opinion is now five years old. The decision reached by the Court of Claims in the case below in reliance on *Spitalny* furthers and promotes judicial erosion and creates uncertainty in the administration of the tax laws by its interpretation of a statutory provision which was clearly designed to remove uncertainty. It should be reversed.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

J. GLENN HAHN
1100 Commerce Bank Building
Kansas City, Missouri 64106
Counsel for Petitioner

Of Counsel:
HARLOW B. KING
WALTER J. KENNEDY
1100 Commerce Bank Building
Kansas City, Missouri 64106

APPENDIX A-1

Opinion of the Court of Claims

IN THE UNITED STATES COURT OF CLAIMS

No. 35-71

(Decided July 14, 1972)

D. B. ANDERS v. THE UNITED STATES

J. Glenn Hahn, for plaintiff; *Harlow B. King*, attorney of record. *Walter J. Kennedy*, of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Joseph Kovner* and *Philip R. Miller*, of counsel.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, DAVIS, SKELTON, NICHOLS, KASHLWA, and KUNZIG, *Judges*.

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

KUNZIG, *Judge*, delivered the opinion of the court:

This is a suit for a refund of federal income taxes paid by plaintiff, as transferee of the assets of D. B. Anders, Inc., formerly Service Industrial Cleaners, Inc. [Service]. Service was a Missouri corporation engaged in the business of renting cleaned and laundered towels, seat covers, fender covers, wiping materials and other textiles and apparels, as well as conducting a cleaning and laundering service of similar items, and in general, conducting an in-

dustrial laundry business. For federal income tax purposes, Service charged the above rental items to its expense account at the time they were purchased. At the end of the taxable year, the expense accounts were credited with the cost of items not yet placed into use.[1]

On May 12, 1961, Service's directors and stockholders passed resolutions approving the terms of a sale of the company's assets and adopting a plan of complete liquidation pursuant to Section 337[2] of the Internal Revenue Code

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1. Items already placed into use, although not used up, were not so credited.

2. "GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

"(a) *General rule.*—If—

"(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

"(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

"(b) *Property defined.*—

"(1) *In general.*—For purposes of subsection (a), the term 'property' does not include—

"(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business * * *.

"(2) *Nonrecognition with respect to inventory in certain cases.*—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term 'property' includes—

"(A) such property so sold or exchanged * * *."

of 1954.[3] On May 22 and 23, Service sold substantially all of its assets, including the rental items in question. Pursuant to the plan of liquidation, Service distributed all of its assets, in complete liquidation, to plaintiff within the 12-month period beginning May 12, 1961. The corporation was dissolved in March, 1962.

In the terms of sale, Service agreed with the purchasers on specific consideration to be paid for the rental items ($117,000).[4] On its income tax return for the fiscal year ended July 31, 1961, Service reported a gain of $163,002.24 from the sale of all its assets, and claimed nonrecognition of the gain under Section 337. This gain included the $117,000 received for the rental items in use.

The sole issue presented by defendant's motion for summary judgment is whether the amounts received from the sale of the previously expensed rental items, as part of the sale of all of Service's assets preceding a complete liquidation, were gain from the sale of property within the provisions of Section 337 for nonrecognition of gain to the corporation, or whether such amounts were taxable as ordinary income to the corporation under the tax benefit principle.[5]

We hold that the amount received was taxable as ordinary income.

Plaintiff alleges that the transfer of the rental items to the buyer was a "sale" of Section 337(b)(1) "property."

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3. All section references hereinafter are to the Internal Revenue Code of 1954.

4. These include rental items which had already been placed into use, but still had remaining serviceable life. *See* note 1 *supra*.

5. For a thorough discussion of the "tax benefit rule" and its applicability to Section 337 liquidations, *see* O'HARE, *Statutory Nonrecognition of Income and the Overriding Principle of the Tax Benefit Rule in the Taxation of Corporations and Shareholders*, 27 TAX L. REV. 215, 222-233 (1972).

He contends that it must follow that the "clear and unambiguous" provisions of Section 337(a) require that the gain from the transfer of these items *not* be recognized to the corporation and that the tax benefit rule is inapplicable.

We agree both that the rental items are "property" under Section 337(b)(1) and that the transfer to the buyer was a "sale." We further concur that if the "gain" had been realized from the "*sale*," it should not have been recognized. However, we feel that the "gain" was not realized from the "sale," but rather from reconverting the previously expensed items into "property."[6]

As noted above, Service had previously expensed these rental items, so that they were no longer shown on Service's books and records as assets. "The expense deduction as permitted by regulation is intended to reflect the cost of [items] *actually* consumed during the taxable year * * *." *Spitalny* v. *United States*, 430 F. 2d 195, 197 (9th Cir. 1970). Normally, the advantage Service gained through the full expensing of these items in one year would have been balanced by the lack of deduction therefor in the following years. However, the effect of the liquidation is to destroy this balance. Plaintiff's

> assignment of a zero basis to expensed items is not in response to adjustments in valuation. It amounts, rather, to a present fictional conversion of that "property" into a consumed item of expense. If the [rental items] are to revert to "property" they should be reconverted. They should not at the same time be property and still retain attributes of a fictional nonentity.

Id. at 198. *Accord*, *Connery* v. *United States*, Nos. 19,432 & 19,433 (3rd Cir., May 22, 1972); *see Commissioner* v. *Anders*,

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6. *I.e.*, the gain was realized from reversing the fictional expensing of the rental items.

414 F. 2d 1283 (10th Cir.) *cert. denied,* 396 U.S. 958 (1969); Murray, "Developing Uncertainties in Section 337 Liquidations—The Tax Benefit Rule and Other Problems," 23 *Tax Lawyer* 181, 183 (1969).

This reconversion of an expensed item into property is accomplished by use of the "tax benefit rule." Simply stated, the "tax benefit rule" requires the inclusion, in taxpayer's income, of an amount which represents a recovery of an item previously deducted, to the extent that the previous deduction was of benefit to him. *See Dobson* v. *Commissioner,* 320 U.S. 489, 505-06 (1943); *Estate of William H. Block,* 39 B.T.A. 338 (1939), *aff'd, Union Trust Co.* v. *Commissioner,* 111 F.2d 60 (7th Cir.), *cert. denied,* 311 U.S. 658 (1940).

Although the "tax benefit rule" usually has been applied where the deduction giving rise to the tax benefit and the recovery occur in different taxable years, it is equally applicable where the deduction and the recovery occur in the same taxable year. *Spitalny* v. *United States, supra* at 198; *see Commissioner* v. *Anders, supra.*

In this case, the "tax benefit rule" gives "to the property sold its true basis as property and den[ies] to it the benefit of an adjusted basis which is false and distorting * * *." *Spitalny* v. *United States, supra* at 198; *see Bishop* v. *United States,* 324 F. Supp. 1105 (M.D. Ga. 1971); *S. E. Evans, Inc.* v. *United States,* 317 F. Supp. 423 (W. D. Ark. 1970). The "tax benefit rule" requires Service to recognize as ordinary income the $117,000 received for the rental items, not as "gain" from the "sale," but as reconversion of the previously expensed items into "property."

We find that plaintiff is not entitled to recover. Therefore defendant's motion for summary judgment is granted and plaintiff's petition is dismissed.

APPENDIX B-1

Statute Involved

Internal Revenue Code of 1954, 26 U.S.C.:

§ 337. Gain or loss on sales or exchanges in connection with certain liquidations

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property defined.—

(1) In general.—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred

to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition with respect to inventory in certain cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

(c) Limitations.—

(1) Collapsible corporations and liquidations to which section 333 applies.—This section shall not apply to any sale or exchange—

(A) made by a collapsible corporation (as defined in section 341(b)), or

(B) following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) Liquidations to which section 332 applies.—In the case of a sale or exchange following the adop-

tion of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b) (1), this section shall not apply; or

(B) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b) (2), this section shall apply only to that portion (if any) of the gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334(b) (2)) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquidating corporation, of the property sold or exchanged.

* * *

APPENDIX B-2

Regulation Involved

U. S. Treas. Reg. § *1.337-3(a)* (*1955*):

* * *

§ 1.337-3. Property defined.—(a) Except as provided in section 337(b)(2) and this section, the term "property" as used in section 337(a) and § 1.337-1 does not include, (1) stock in trade of the corporation, or other property of a kind which would properly be included in the

inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as "inventory"), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed in this paragraph, the term "property" includes all assets owned by a corporation.

* * *

APPENDIX B-3

Rule Involved

Rules, United States Court of Claims:

VIII. SUMMARY JUDGMENT; DISMISSALS

RULE 101. SUMMARY JUDGMENT

* * *

(d) Motion and Proceedings Thereon: After a motion for summary judgment has been filed, and after the expiration of the time allowed for a response thereto or for a reply to the response, if any (Rule 52(b)), such motion may (subject to the provisions of Rules 54(b), 146 (b) (2), and 166(b)) be assigned to the calendar. (See Rule 14(b) (2).) The judgment sought shall be rendered if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no

genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

• • •

(f) Form of Affidavits; Further Testimony: Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions or by further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, will be entered against him.

• • •

APPENDIX C-1

Petition to United States Court of Claims

IN THE
UNITED STATES COURT OF CLAIMS

No. _____

D. B. ANDERS,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

Petition

1. The plaintiff is a citizen of the United States of America, now residing at 8448 Valley View Drive, Overland Park, Kansas 66212 (formerly 6665 Outlook Drive, Shawnee Mission, Kansas).

2. The defendant is the United States of America.

3. This is an action for the recovery of internal revenue taxes and this Court has jurisdiction by reason of Title 28, U. S. C. Section 1491.

4. Recovery is sought of federal income taxes for the taxable year ended July 31, 1961 paid by plaintiff as transferee of the assets of D. B. Anders, Inc. (formerly Service Industrial Cleaners, Inc.), a Missouri corporation now dissolved, which had its principal place of business

at 3612 East 27th Street, Kansas City, Missouri (hereinafter referred to as "Service"). On or about January 15, 1962, Service timely filed its form 1120, U. S. Corporation Income Tax Return, for its taxable year ended July 31, 1961, with the District Director at St. Louis, Missouri, and paid income taxes on account of such return in the amount of $13,334.66. The District Director assessed against the plaintiff as transferee of the assets of Service additional taxes of $3,998.61 plus interest for the taxable year ended July 31, 1961, which assessment was paid by plaintiff on or about May 27, 1963. Of this amount, the sum of $3,771.17 tax plus interest thereon was refunded by defendant to plaintiff on or about August 16, 1966, pursuant to claim for refund duly filed by plaintiff. Plaintiff agreed to the disallowance of the balance of said claim, and there is no issue here with respect to said May 27, 1963 assessment. On or about November 13, 1964, the District Director at Wichita, Kansas, assessed against the plaintiff as transferee of Service additional income taxes and interest of $71,800.72 for the said taxable year of Service ended July 31, 1961. On or about November 23, 1964, the plaintiff paid to the said District Director on account of such assessment against him as transferee the sum of $71,800.72. Plaintiff alleges that such additional income taxes and interest were erroneously and illegally assessed and collected and demands recovery of $71,800.72, together with such interest as is allowed by law.

5. On or about July 6, 1966, plaintiff filed with the District Director at St. Louis, Missouri, a claim for refund, a copy of which is attached hereto, marked Exhibit A and made a part hereof. An identical claim for refund was also filed on said date with the District Director at Wichita, Kansas. On or about December 23, 1966, the District Director at St. Louis, Missouri, advised plaintiff that he had

forwarded said claim to the District Director at Wichita, Kansas. On or about March 5, 1970, the Appellate Division of the Internal Revenue Service at Kansas City, Missouri, to which the claim had been transferred for hearing, mailed to plaintiff by certified mail a notice of disallowance of the claim for refund.

6. Plaintiff has as transferee of Service overpaid the federal income taxes of Service for said taxable year ended July 31, 1961, is the sole owner of the aforementioned claim for refund, and has made no assignment of that claim.

7. On or about May 12, 1961, the board of directors and stockholders of Service adopted a plan of complete liquidation pursuant to Title 26, U. S. C. Section 337. On or about May 22 and May 23, 1961, pursuant to an agreement entered into on or about May 16, 1961, Service sold to a single, unrelated purchaser for a total consideration of $305,006.43 substantially all the assets of Service's industrial laundry business. Of this total amount the sum of $117,000 was received with respect to Service's entire inventory of towels, seat covers, fender covers, wiping materials, dusting cloths, coats, coveralls, shirts, pants, and other apparel and textiles, dusting and sweeping equipment, and all other items used in the conduct of its rental service business. Pursuant to the said plan of complete liquidation and within the 12-months' period beginning on May 12, 1961, Service distributed all its assets in complete liquidation to plaintiff herein, its sole stockholder. Service was dissolved on or about March 29, 1962. The total gain realized by Service in the amount of $163,002.24 arising out of the aforesaid sale of substantially all its assets was properly excludible from taxable income for Service's said taxable year ended July 31, 1961 under said Section 337 as gain realized from the sale or exchange of property within the 12-month period following the adoption

of a plan of complete liquidation. The Appellate Division of the Internal Revenue Service at Kansas City, Missouri, erroneously and illegally treated that portion of the gain realized from the sale of Service's entire inventory of items in use in its laundry rental service business as taxable income.

WHEREFORE, plaintiff prays for judgment in the amount of $71,800.72, plus such interest and costs as are allowed by law, and such other relief as the Court may deem just and equitable.

.....

Harlow B. King
1100 Commerce Bank Building
Kansas City, Missouri 64106

.....

J. Glenn Hahn
1100 Commerce Bank Building
Kansas City, Missouri 64106

.....

Walter J. Kennedy
1100 Commerce Bank Building
Kansas City, Missouri 64106

Of Counsel:
Hoskins, King, Springer, McGannon and Hahn
1100 Commerce Bank Building
Kansas City, Missouri 64106

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A15

Exhibit A

EXHIBIT A

Form 843 (Rev. June 1968)
U.S. Treasury Department (Internal Revenue Service)

SUPPLEMENTAL **Claim**

Director's Stamp (Date received)

The Internal Revenue Service will indicate in the block below the kind of claim filed, and fill in, where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to income, estate or gift taxes).

Please Type or Print Plainly

Name of taxpayer or purchaser of stamps
D. B. Anders, Alleged Transferee of D. B. Anders, Inc. (Missouri)

Number and street
8448 Valley View Drive

City or town, State, and ZIP code
Overland Park, Kansas 66212

Fill in applicable items—Use attachments if necessary

a. Your social security number | Wife's number, if joint return | b. Employer identification number (if any)

c. Internal Revenue Service office where return (if any) was filed
Kansas City, Missouri

d. Name and address shown on return, if different from above
D. B. Anders, Inc. (formerly Service Industrial Cleaners, Inc.) 3612 East 27th, Kansas City, Missouri

e. Period—if for tax reported on annual basis, prepare separate form for each taxable year
From August 1, 1960, to July 31, 1961

f. Kind of tax
Income

g. Amount of assessment
$ 78,172.87

Dates of payment
Oct. 15, 1961; Jan. 15, 1962; May 27, 1963; Nov. 23, 1964

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below)
$ 60,839.60*

j. Amount to be abated (not applicable to income, estate, or gift taxes)
$

k. The claimant believes that this claim should be allowed for the following reasons:

SEE ATTACHED STATEMENT

*or such greater amount as may be legally refundable, plus interest as provided by law.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1 Tax withheld	
2 Estimated tax paid	
3 Tax paid with original return	$13,334.66
4 Any additional income tax paid	$64,838.21
5 Total tax paid (add lines 1–4)	$78,172.87
6 Less: Your computation of correct tax	$13,334.66
7 Amount of overpayment	$64,838.21
8 Amount ~~previously refunded~~. Claim filed May 18, 1965	$ 3,998.61
9 Net overpayment (enter in item i above)	$60,839.60

Under penalties of perjury, I declare that I have examined this claim, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Signed .....

Dated ....., 19 .....

SEE INSTRUCTIONS ON REVERSE

Form 843 (Rev. 6-68)

COPY PRINTED CLOSE TO EDGE

Form 843, Claim for Refund

STATEMENT

D. B. Anders
Alleged Transferee of D. B. Anders, Inc. (Missouri)
8448 Valley View Drive
Overland Park, Kansas 66212

1. D. B. Anders, Inc. (formerly Service Industrial Cleaners, Inc.), hereinafter called "Service", a Missouri corporation, having its principal office at Kansas City, Missouri, filed its Form 1120, U. S. Corporation Income Tax Return, for its taxable year ended July 31, 1961, with the District Director of Internal Revenue at Kansas City, Missouri.

2. On or about May 12, 1961, the Board of Directors and stockholders of Service adopted a plan of complete liquidation pursuant to Section 337 of the I. R. C., 1954.

3. On or about May 16, 1961, Service entered into an agreement to sell to Albert Gitlow, Abraham Gitlow, Ben E. Singer, and Joseph L. Fradkin, acting on behalf of Service Industrial Cleaners, Inc., a Kansas corporation formed on or about May 17, 1961, which corporation is hereinafter called "Buyer", substantially all the assets of Service's industrial laundry business. Under the terms of this agreement Service sold to Buyer the following assets for the consideration stated:

(a) Its entire inventory of towels, seat covers, fender covers, wiping materials, dusting cloths, coats, coveralls, shirts, pants, and other apparel and textiles, dusting and sweeping equipment, and all other items used in the conduct of its rental service business	$117,000.00

(b) Furniture, fixtures, machinery, tables, garbage disposal and refrigeration units and miscellaneous equipment, including office equipment and miscellaneous supplies	49,610.00
(c) Goodwill and customers patronage	50,000.00
(d) Real estate	63,000.00
(e) Accounts receivable	25,396.43

4. Service ceased the active conduct of business upon the completion of the aforesaid sale to Buyer on May 22 and 23, 1961. Thereafter, the only business conducted by Service was the winding up of its affairs. Pursuant to its plan of complete liquidation under Section 337, I. R. C., 1954, and within the 12-months' period beginning on May 12, 1961, Service distributed all its assets in complete liquidation to D. B. Anders, its sole stockholder, claimant herein. Anders is an individual, residing at 8448 Valley View Drive, Overland Park, Kansas 66212. On or about March 29, 1962, Service was liquidated and dissolved under the laws of the State of Missouri.

5. On its Federal income tax return for its taxable year ended July 31, 1961, Service reported a gain in the amount of $163,002.24 arising out of the aforesaid sale of substantially all its assets to Buyer, the total amount of which gain Service excluded from taxable income pursuant to Section 337, I. R. C., 1954. Included in the amount so excluded was gain in the amount of $117,000, the amount of consideration received by Service for its entire inventory of articles in use in its laundry rental service business.

6. The Federal income tax return of Service for its taxable year ended July 31, 1961, was examined by the Internal Revenue Service. A deficiency in tax in the amount of $3,998.61 was determined upon the original examination and a further deficiency in tax in the amount of $60,839.60 was determined upon a supplemental examination. The amounts of these deficiencies were asserted against D. B. Anders, as alleged transferee of the assets of Service, and were paid by him as set out in paragraph 11 below.

7. The deficiency in the amount of $3,998.65 was based upon an erroneous determination by the Internal Revenue Service that depreciation in the amount of $7,704.11 claimed on depreciable assets in the year of sale was not allowable. A claim for refund of this amount was filed May 18, 1965, with the District Director of Internal Revenue, Wichita, Kansas.

8. The deficiency in the amount of $60,839.60 was based upon an erroneous determination by the Internal Revenue Service that $117,000 of the $163,002.24 gain realized by Service on the sale of its assets to Buyer was not excluded from taxable income under Section 337. The $117,000, representing that portion of the gain realized from the transfer to Buyer of Service's entire inventory of items in use in its laundry rental service business, constitutes gain realized from the sale or exchange of property within the 12-month period following the adoption of a plan of complete liquidation, and as such, is properly excludible from taxable income under Section 337, I. R. C., 1954.

9. Service paid its Federal income taxes for its taxable year ended July 31, 1961, to the District Director of Internal Revenue, Kansas City, Missouri, as follows:

Date Paid	Amount
October 11, 1961	$ 9,000.00
January 12, 1962	4,334.66
Total paid per return	$13,334.66

10. Anders, as alleged transferee of Service, paid additional Federal income taxes assessed against Service for Service's taxable year ended July 31, 1961, to the District Director of Internal Revenue, Wichita, Kansas, as follows:

Date Paid	Additional Tax
May 27, 1963	$ 3,998.61
November 23, 1964	$60,839.60

11. The amount of the overpayment claimed herein is computed as follows:

Taxable income per return	$46,006.55
Income tax due thereon	$13,334.66
Tax paid	78,172.87
Amount of overpayment	$64,838.21
Amount previous claim	3,998.61
Amount of this claim	$60,839.60

NOTE: Because the tax return of the transferor, Service, was filed and the tax shown as due thereon paid to the District Director of Internal Revenue, Kansas City, Missouri, and the taxes assessed against Anders as transferee were assessed by and paid to the District Director of Internal Revenue, Wichita, Kansas, this claim is being filed simultaneously with the District Director of St. Louis, Missouri, and Wichita, Kansas.

APPENDIX C-2

Defendant's Answer

IN THE UNITED STATES COURT OF CLAIMS

No. 35-71

D. B. ANDERS,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

ANSWER

(June 4, 1971)

Defendant, the United States of America, by its attorneys, in answer to the petition filed in the above-entitled case, respectfully denies each and every allegation contained therein, except as specifically admitted herein. Defendant further:

1. Admits the allegations contained in paragraph 1.

2. Admits the allegations contained in paragraph 2.

3. Admits the allegations contained in paragraph 3.

4. Admits the allegations contained in paragraph 4 except denies the allegations contained in the last sentence of paragraph 4.

5. Admits the allegations contained in paragraph 5 except to deny each and every allegation set forth in the refund claim unless otherwise expressly admitted herein.

6. Admits the allegations contained in paragraph 6, except to deny that plaintiff overpaid the taxes mentioned.

7. Admits the allegations contained in paragraph 7, except denies the last two sentences of paragraph 7; defendant further avers that prior to the liquidation sale, business expense deductions from the taxable income had been taken by Service for its entire inventory of items in use in its laundry rental service business; these deductions were recovered in the gain realized by Service from the liquidation sale, and this portion of the gain was, therefore, properly includible in the year of recovery.

WHEREFORE, defendant prays that plaintiff's petition be dismissed at its own costs.

Respectfully submitted,

/s/ Johnnie M. Walters
Johnnie M. Walters
Assistant Attorney General

/s/ Kenneth R. Boiarsky
Kenneth R. Boiarsky
Attorney
May 26, 1971

APPENDIX D-1

Standard Pretrial Order on Liability, Rule 111

IN THE UNITED STATES COURT OF CLAIMS

No. 35-71

(Filed June 7, 1971)

D. B. ANDERS,
Plaintiff,*

v.

THE UNITED STATES,
Defendant.

STANDARD PRETRIAL ORDER
ON LIABILITY
(RULE 111)

IT IS ORDERED as follows:

1. *Plaintiff's Submission.* On or before August 6, 1971, the plaintiff* shall furnish the following to the attorney of record for the defendant and to the commissioner:

(a) A list accurately describing the documents that are relied on and are to be offered in evidence. The documents shall be numbered; and the list shall be accompanied by a copy of each document referred to therein, except that (1) no copy need be supplied to defendant's

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*The word "plaintiff," as used in this order, means "plaintiffs" in a case where two or more persons have joined together in filing a petition.

counsel where the plaintiff reasonably believes that the defendant already has the original or a copy, and (2) the commissioner need not be provided a copy of any exhibit unless its admissibility is put in issue.

(b) A statement of the material matters of fact as to which it is believed that there is no substantial controversy between the parties, or which have been agreed to by the parties. The paragraphs of this statement shall be numbered.

(c) A memorandum of contentions of fact and law, which shall comply with the following requirements:

(1) The contentions of fact shall consist of a concise statement of the ultimate, material facts which the plaintiff expects to establish, rather than a general statement of the claim or a repetition of the pleadings.

(2) The contentions of law shall be in the form of conclusions of law based on the ultimate facts which the plaintiff expects to establish, and, in addition, shall contain a brief statement of the points of law and a citation of the authorities relied upon in support of each point.

(d) (1) A list setting forth the name, address, and occupation of each of the witnesses whom the plaintiff proposes to call, and a succinct statement of the issue or issues to which the testimony of each witness will relate.

(2) The preferred date for the beginning of the trial, and the preferred place or places therefor.

(3) An approximation of the time that will be required for the direct examination of the plaintiff's witnesses at each place.

2. *Defendant's Response.* Within 45 days after receiving the data referred to in paragraph 1 of this order,

the defendant shall furnish the following to the attorney of record for the plaintiff and to the commissioner:

(a) A statement admitting or denying the admissibility of each document listed under paragraph 1(a) of this order, together with the reasons for any denial of admissibility, and a further statement admitting or denying the genuineness of any documents the admissibility of which is disputed.

(b) A statement (arranged in numbered paragraphs) agreeing to, denying, revising, or otherwise commenting on the factual data submitted under paragraph 1(b) of this order.

(c) A list of the proposed defense exhibits, meeting the requirements of paragraph 1(a) of this order.

(d) A statement setting out any further material matters of fact as to which the defendant believes that there is no substantial controversy between the parties. The paragraphs of this statement shall be numbered.

(e) A memorandum of contentions of fact and law, which shall comply with the requirements set forth in paragraph 1(c) of this order.

(f) A list of the proposed defense witnesses, complying with the requirements of paragraph 1(d)(1) of this order.

(g) A statement indicating the defendant's preference as to the date and location of the trial.

(h) An estimate of the time likely to be required for the presentation of the direct testimony of the defendant's witnesses, and the cross-examination of the plaintiff's witnesses, at each preferred location.

3. *Plaintiff's Reply.* Within 30 days after receiving the data referred to in paragraph 2 of this order, the plaintiff shall furnish the following to the attorney of record for the defendant and to the commissioner:

(a) A statement agreeing to, denying, or otherwise commenting on any revised or additional factual data submitted under paragraph 2(b) and (d) of this order.

(b) Such observations in rebuttal as the plaintiff may wish to offer respecting the defendant's contentions of fact and law submitted under paragraph 2(e) of this order.

(c) A statement admitting or denying the admissibility of each of the documents listed under paragraph 2(c) of this order, together with the reasons for any denial of admissibility, and a further statement admitting or denying the genuineness of any documents the admissibility of which is disputed.

(d) An estimate of the time likely to be required for the cross-examination of defendant's proposed witnesses at each preferred location.

4. *Form of Compliance.* For convenience of reference, submissions in compliance with this order shall follow the format of the order by citing the numbered paragraph pursuant to which each portion of a particular submission has been prepared.

5. *Sanctions.* Rule 114(b) provides sanctions for failure or refusal to comply with the requirements of this order.

Mastin G. White
Commissioner

APPENDIX D-2

Plaintiff's Submission Pursuant to Standard Pretrial Order (Rule 111)

IN THE
UNITED STATES COURT OF CLAIMS

No. 35-71

D. B. ANDERS,
Plaintiff,

vs.

THE UNITED STATES OF AMERICA,
Defendant.

PLAINTIFF'S SUBMISSION PURSUANT TO STANDARD PRETRIAL ORDER (RULE 111)

Comes now the plaintiff by his attorney, Harlow B. King, and in compliance with Standard Pretrial Order on Liability filed herein June 7, 1971, submits the following:

1. (a) *List of documents.* The following documents are relied on and are to be offered in evidence:

(1) Form 1120, U. S. Corporation Income Tax Return of D. B. Anders, Inc., a Missouri corporation, formerly Service Industrial Cleaners, Inc. (hereinafter referred to as "Service") for its taxable year ended July 31, 1961;

(2) Minutes of special meeting of the Board of Directors of Service dated May 12, 1961;

(3) Minutes of special meeting of the stockholders of Service dated May 12, 1961;

(4) Agreement of Sale dated May 16, 1961, between Service and Albert Gitlow, Abraham Gitlow, Ben E. Singer, and Joseph L. Fradkin, acting in behalf of Service Industrial Cleaners, Inc., a Missouri corporation formed by said Albert Gitlow *et al.* on or about May 17, 1961, which corporation is hereinafter referred to as "Buyer";

(5) Restrictive Covenants Agreement dated May 17, 1961 between Buyer and D. B. Anders, an individual, the plaintiff, hereinafter referred to as "Anders";

(6) A second Restrictive Covenants Agreement dated May 22, 1961, between Buyer and Service;

(7) Bill of Sale from Service to Buyer dated May 22, 1961;

(8) "Memorandum Relating and Applying to Four Certain Agreements of Sale Entered into Respectively Between D. B. Anders, Inc." et al. dated May 22, 1961;

(9) Articles of Incorporation and all amendments thereto and Articles of Dissolution of Service;

(10) Statutory notice of liability mailed to Anders on July 7, 1964;

(11) Proof of payment by Anders as transferee on or about November 23, 1964, of a deficiency in Federal income tax of Service for its taxable year ended July 31, 1961, in the amount of $60,839.60;

(12) Statutory notice of disallowance of claim for refund in the amount of $60,839.60 dated March 2, 1970.

(b) A statement of material matters of fact about which it is believed that there is no substantial controversy:

(1) D. B. Anders is an individual residing in Overland Park, Kansas.

(2) Service was a corporation organized in March, 1949, under the laws of Missouri with its principal offices in Kansas City, Missouri. At all times material its stock was owned by Anders directly or through his nominees. By amendment filed May 17, 1961, Service's name was changed to D. B. Anders, Inc.

(3) Service timely filed a corporation income tax return for the fiscal year ended July 31, 1961, on an accrual basis with the district director of Internal Revenue at St. Louis, Missouri.

(4) Service was engaged in the business of conducting and providing a rental service of cleaned and laundered towels, seat covers, fender covers, wiping materials and dust cloths, coats, coveralls, shirts, pants, and other textiles and apparels, including dusting and wiping equipment, sweeping tools, mops, and accessories, herein referred to collectively as rental items, as well as conducting a cleaning and laundering service of substantially the same type of items owned by others, and in general conducting an industrial laundry business.

(5) For Federal income tax purposes Service charged to its expense accounts when purchased the cost of the rental items used in conducting its rental

service business. At the end of each taxable year the expense accounts were credited with the costs of the ending inventory of items which had not been placed in service at the end of the taxable year.

(6) In May, 1961, Anders reached an agreement for the sale of Service's business to a group of persons. The purchasers desired to carry on the business under a different corporation with the same name.

(7) On May 12, 1961, the board of directors and the stockholders of Service adopted resolutions approving and authorizing the sale of the corporation's properties and business, changing the corporate name to D. B. Anders, Inc. and adopting a plan of complete liquidation pursuant to the terms of Section 337 of the Internal Revenue Code of 1954.

(8) As of May 16, 1961, Service entered into an "Agreement of Sale" with Albert Gitlow, Abraham Gitlow, Ben E. Singer, and Joseph L. Fradkin, herein referred to as the purchasers, acting in behalf of Buyer.

(9) Under the agreement Service as "Seller" and the named individuals as "Purchasers" agreed to the sale and transfer to the purchasers or their assigns of all seller's inventory of the articles used in conducting the seller's rental service business, furniture and equipment, accounts receivable, interest in real property, name, routes, customers' patronage, and goodwill.

(10) The price was stated in the contract as follows:

Inventory of rental items	$116,000
Furniture and equipment	49,610
Sweeping tools, mops and accessories	1,000
Goodwill and customer patronage	50,000
Real property	63,000
Total	$279,610

In addition, there was to be paid a sum equal to the trade accounts receivable at the close of business May 17, 1961, and prepaid items as of that date.

(11) As of May 17, 1961, Anders entered into a covenant with the purchasers to refrain from competition with them or their corporation in the conduct of rental service or laundry business.

(12) As of May 22, 1961, Service, then known as D. B. Anders, Inc., entered into an agreement with the purchasers to a similar effect. As of the same date Service delivered to the buyer a bill of sale of certain assets. On or about May 22 or 23, 1961, the sale by Service of substantially all its assets to the buyer was completed.

(13) Pursuant to the plan of liquidation Service distributed all its assets in complete liquidation to petitioner, its sole stockholder, within the 12-month period beginning May 12, 1961.

(14) The corporation filed with the secretary of state of the State of Missouri its resolution of dissolution in March, 1962 and its corporate existence ceased.

(15) The corporation paid its Federal income taxes for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
October 11, 1961	$9,000.00
January 12, 1962	4,334.66

(16) Anders paid additional Federal income taxes assessed against the corporation for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
May 27, 1963	$ 3,998.61
November 23, 1964	60,839.60

(17) On its income tax return for the fiscal year ended July 31, 1961, the corporation reported a gain of $163,002.24 arising out of the sale of substantially all its assets to the buyer, and claimed exclusion of such gain from taxable income under Section 337, I.R.C. of 1954. The gain reported included $117,000 which was the amount of the consideration received by Service from Buyer allocated to the items-in-use in its laundry rental business.

(c) *Memorandum of Contentions of Fact and Law*

(1) *Contentions of Fact.* Plaintiff expects to establish the following ultimate material facts:

(i) On or about May 12, 1961, Service adopted a plan of complete liquidation pursuant to Section 337 of the Internal Revenue Code, and within the 12-month period beginning on the date of the adoption of the plan, distributed all its assets in complete liquidation to Anders, its sole stockholder.

(ii) Following the adoption of said plan of liquidation and pursuant to an agreement of sale entered into on or about May 16, 1961, Service did on May 22-23, 1961, sell, transfer and deliver to the Buyer in one transaction substantially all its assets, including the garments, shop towels, fender and seat covers, and dust control items in circulating use in Service's industrial laundry business.

(2) *Contentions of Law.* Plaintiff's case is based upon the following contentions of law:

(i) The garments, shop towels, fender and seat covers, and dust control items in use by Service in 1961 in its industrial laundry business constituted "property" within the intendment of Section 337 (b)

(1) of the Internal Revenue Code of 1954.

I.R.C. 1954, 26 U.S.C.A. Sec. 337 (b) (1)

U. S. Treas. Reg., Sec. 1.337-3(a)

Malat v. *Riddell*, 383 U.S. 569, 571 (1966)

Jeanese, Inc. v. *United States*, 227 F. Supp. 304 (N.D. Cal. 1964), *rev'd. on other grounds*, 341 F.2d 502 (9th Cir. 1965)

D. B. Anders, 48 T.C. 815 (1967), *rev'd.* 414 F.2d 1283 (10th Cir. 1969), *cert. denied* 396 U. S. 958 (1969)

Frank W. Verito, 43 T.C. 429 (1965).

(ii) The May, 1961, transfer by Service to the Buyer of the garments, shop towels, fender, and seat covers, and dust control items then in circulating use in its industrial laundry business constituted a

sale or exchange within the intendment of Section 337 (a) of the Internal Revenue Code of 1954.

I.R.C. 1954, 26 U.S.C.A. Sec. 337 (a)

U.S. Treas. Reg., Sec. 1.337-2

Commissioner v. *Brown*, 380 U.S. 563, 570-71 (1965)

Frank W. Verito, supra

George J. Aitken, 35 T.C. 227 (1960)

(iii) In the alternative, if the garments, shop towels, fender and seat covers and dust control items in circulating use by Service in its industrial laundry business did not constitute "property" within the intendment of Section 337 (b) (1) of the Internal Revenue Code of 1954, then they did constitute stock in trade or other property of a kind properly includible in inventory within the scope of Section 337 (b) (1) (A), and substantially all of said property was sold or exchanged to one person in one transaction within the intendment of Section 337 (b) (2), Internal Revenue Code of 1954.

I.R.C. 1954, 26 U.S.C. Secs. 337 (b) (1) (A) and 337 (b) (2).

U. S. Treas. Reg. Sec. 1.337-3(b).

Jeanese, Inc. v. *United States, supra.*

(d) (1) Plaintiff plans to call as witnesses the following:

(i) D. B. Anders, 8448 Valley View Drive, Overland Park, Kansas, formerly president of Service. Anders will testify as to the operation of Service's industrial laundry business, the rental of industrial laundry items, the adoption of the Section 337 Plan of

Liquidation, the sale to the Gitlow interests, and the liquidation of Service.

(ii) William E. Mangold, C.P.A., Power and Light Building, Kansas City, Missouri. Mangold will testify as to the accounting practice of Service, the reporting of the sale to the Gitlow interests on Service's final corporate income tax return, and the final distributions of assets at date of liquidation.

In the alternative, there is the possibility that the case can be submitted entirely upon a written stipulation of facts, if all the necessary facts can be mutually agreed upon by the parties.

(2) The preferred date for the beginning of the trial is on or about December 1, 1971, and the preferred place is Kansas City, Missouri.

(3) It is estimated that approximately four (4) hours total time will be required for direct examination of plaintiff's witnesses.

Respectfully submitted,

Harlow B. King
Attorney for Plaintiff

Of Counsel:
J. Glenn Hahn
Walter J. Kennedy

APPENDIX E-1

Defendant's Motion for Summary Judgment and Brief in Support Thereof

IN THE UNITED STATES COURT OF CLAIMS

No. 35-71

D. B. ANDERS,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

MOTION OF THE UNITED STATES FOR SUMMARY JUDGMENT

Comes now the defendant, the United States of America, pursuant to Rule 101 of the Rules of the United States Court of Claims, and respectfully moves the Court to grant summary judgment in its favor for the reason that the pleadings and plaintiff's pretrial submission of August 5, 1971 (Appendix to Brief, *infra*), show that there is no genuine issue of fact and the defendant is entitled to judgment as a matter of law.

Respectfully submitted,

/s/ Scott P. Crampton
Scott P. Crampton
Assistant Attorney General

/s/ Kenneth R. Boiarsky
Kenneth R. Boiarsky
Attorney
December 14, 1971

BRIEF FOR THE UNITED STATES IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

This is a suit for the recovery of federal corporate income taxes and interest in the amount of $71,800.72 for the fiscal year ended July 31, 1961, plus statutory interest thereon.

QUESTION PRESENTED

Whether the amount received from rental items of apparel, towels, and the like, in a sale of corporate assets preceding a complete liquidation was a gain from the sale of property within the provisions of Section 337 of the Internal Revenue Code of 1954 for nonrecognition of gain to the corporation where the cost of such items had been fully expensed when they were purchased, or whether such gain was taxable as ordinary income to the corporation under tax benefit principles.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) *General Rule.*—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) *Property Defined.*—

(1) *In general.*—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) *Nonrecognition with respect to inventory in certain cases.*—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

• • •

STATEMENT

Service Industrial Cleaners, Inc. (Service), was a Missouri corporation engaged in the business of conducting and providing a rental service of cleaned and laundered towels, seat covers, fender covers, wiping materials and dust cloths, coats, coveralls, shirts, pants, and other textiles and apparels, including dusting and wiping equipment, sweeping tools, mops, and accessories, herein referred to collectively as rental items, as well as conducting a cleaning and laundering service of substantially the same type of items owned by others, and in general conducting an industrial laundry business. (Pltf. Pretrial Submission, par. 1(b)(2), 1(b)(4).) For federal income tax purposes, Service charged to its expense accounts, when purchased, the cost of the rental items described; at the end of each taxable year, the expense accounts were credited with the cost of items not placed in service during the year. (Pltf. Pretrial Submission, par. 1(b)(5).)

In May, 1961, plaintiff Anders, owner of the stock of Service directly or through nominees (Pltf. Pretrial Submission, par. 1(b)(2)), made an agreement for the sale of the business and properties of Service. (Pltf. Pretrial Submission, par. 1(b)(6).) On May 12th, Service's directors and stockholders passed resolutions approving the terms of sale and adopting a plan of complete liquidation pursuant to Section 337 of the 1954 Code. (Pltf. Pretrial Submission, par. 1(b)(7); Pet. Ex. A, par. 2.) On May 16, 1971, Service executed a written agreement of sale with the individuals purchasing the business who were acting in behalf

of a newly formed Kansas corporation also known as Service Industrial Cleaners, Inc. (Pltf. Pretrial Submission, par. 1(b)(8); Pet. Ex. A, par. 3.)

By amendment filed May 17, 1961, Service's name was changed to D. B. Anders, Inc. (hereinafter also referred to as "Service") (Pltf. Pretrial Submission, par. 1(b)(2), 1(b)(7).) On May 22 and 23, Service sold substantially all of its assets, including the rental items in question, to the purchasers. (Pltf. Pretrial Submission, par. 1(b)(12); Pet. Ex. A, par. 4.) Pursuant to the plan of liquidation, Service distributed all of its assets in complete liquidation to plaintiff within the 12-month period beginning May 12, 1961, and the corporation was dissolved in March, 1962. (Pltf. Pretrial Submission, par. 1(b)(13), 1(b)(14); Pet. Ex. A, par. 4.)

In the terms of sale, Service agreed with the purchasers on specific consideration to be paid for the rental items in question, and also specified consideration to be paid for furniture and machinery, goodwill, realty, and accounts receivable. (Pltf. Pretrial Submission, par. 1(b)(10); Pet. Ex. A, par. 3.) On its income tax return for the fiscal year ended July 31, 1961, Service reported a gain of $163,002.24 from the sale of all such property, and claimed nonrecognition of the gain under Section 337; this gain included $117,000 received for the rental items in use. (Pltf. Pretrial Submission, par. 1(b)(17); Pet. Ex. A, par. 5.)

Pursuant to audit by the Internal Revenue Service of Service's federal income tax return filed on the accrual basis (Pltf. Pretrial Submission, par. 1(b)(3)) for its taxable year ended July 31, 1961, certain deficiencies and interest were assessed against, and paid by, plaintiff as transferee of the assets of Service, which, insofar as relevant here, were based upon the determination by the Internal Revenue Service that $117,000 of the $163,002.24 gain

realized by Service on the sale of its assets attributable to the rental items was not entitled to nonrecognition under Section 337. (Pet. par. 4, and Ex. A thereto, par. 8.) A claim for refund was filed thereon and disallowed on March 5, 1970. (Pet. par. 5.)

ARGUMENT

The precise issue raised in this action has been decided under a substantially identical factual setting in *Anders* v. *Commissioner*, 414 F. 2d 1283 (C.A. 10, 1969), rev'g 48 T.C. 815 (1967), cert. denied, 396 U.S. 958 (1969), rehearing denied, 396 U.S. 1031 (1970). Plaintiff in that action was the same as here (though in that case as transferee of Service Industrial Cleaners, Inc., a Kansas corporation, and here as transferee of D. B. Anders, Inc., formerly Service Industrial Cleaners, Inc., a Missouri corporation). The Tenth Circuit in *Anders* held that the tax benefit principles were applicable to deny nonrecognition under the pertinent portions of Section 337 of the 1954 Code, *supra*, and that "Under such principles the proceeds of the rental items should properly be treated as recoupment of the expense charges," thus giving rise to ordinary income. The heart of the opinion reads as follows (414 F. 2d, pp. 1287-1288):

> We turn to a consideration of this case under tax benefit principles. The rental items in question had a zero basis and their cost had been fully expensed on purchase by Service in its Federal income tax returns and deductions were taken therefor by Service. In similar circumstances a recovery of property by the taxpayer was treated as recoupment of prior charitable deductions and as taxable income. *Alice Phelan Sullivan Corporation* v. *United States*, 381 F. 2d 399, 402, 180 Ct. Cl. 639 (1967). In view of Service's charg-

ing the full cost of the rental items to expense, the "* * * increment realized in this area over and beyond adjusted basis does not then represent any gain in capital or asset value." *West Seattle National Bank of Seattle* v. *Commissioner*, *supra*, 288 F. 2d at 49. The *West Seattle* case involved the transfer of loans receivable at face value with recoupment thereby affected of prior bad debt charges. We conclude that the logic of tax benefit principles applies here, despite various distinctions suggested between Service's case and existing tax benefit decisions. Under such principles the proceeds of the rental items should properly be treated as recoupment of the expense charges. See *Alice Phelan Sullivan Corporation* v. *United States*, *supra*; *Citizens Federal Savings & Loan Association of Cleveland* v. *United States*, *supra*; *West Seattle National Bank of Seattle* v. *Commissioner*, *supra*; *Commissioner* v. *First State Bank of Stratford*, 168 F. 2d 1004, 7 A.L.R. 2d 728 (5th Cir. 1948), cert. denied, 335 U.S. 867, 69 S. Ct. 137, 93 L. Ed. 412 (1948); *Merchants National Bank of Mobile* v. *Commissioner*, *supra*, 199 F. 2d at 659 (taxing proceeds of sale of notes charged off to a zero basis); *William Eugene Monday, Jr.*, 16 T.C.M. 1, affirmed per curiam, *Monday* v. *C.I.R.*, 252 F. 2d 789 (6th Cir. 1958), cert. denied, 358 U.S. 883, 79 S. Ct. 124, 3 L. Ed. 2d 112 (1958); *Lloyd H. Faidley*, 8 T.C. 1170 (1947).

The taxpayer maintains that such principles may not apply since the rental items in question come literally within the general meaning of property in § 337. Thus, it is argued, on disposition of the rental items the proceeds must be treated as gain from the sale of property. We do not agree. The fact that a transaction involves disposition of property does not compel treatment of the proceeds as gain from such a

transfer. *Commissioner* v. *Gillette Motor Co.*, 364 U.S. 130, 134, 80 S. Ct. 1497, 4 L. Ed. 2d 1617 (1960); *United States* v. *Eidson*, 310 F. 2d 111, 113-114 (5th Cir. 1962), modified on other grounds, 312 F. 2d 744 (5th Cir. 1963); *West Seattle National Bank of Seattle* v. *Commissioner*, *supra*; cf. *Dyer* v. *Commissioner*, 294 F. 2d 123 (10th Cir. 1961) and *Commissioner* v. *First State Bank of Stratford*, *supra*. Instead, we conclude that tax benefit principles call for treatment of the proceeds not as gain from the sale of property, but as ordinary income which was deducted on its purchase.

We believe that the *Anders* decision is soundly based on principles upheld by this Court and should be followed. See also *Spitalny* v. *United States*, 430 F. 2d 195 (C.A. 9, 1970); *S. E. Evans, Inc.* v. *United States*, 317 F. Supp. 423 (Ark., 1970); *Bishop* v. *United States*, 324 F. Supp. 1105 (Ga., 1971).

CONCLUSION

For the foregoing reasons, the defendant's motion for summary judgment should be granted and the petition dismissed.

Respectfully submitted,

/s/ Scott P. Crampton
Scott P. Crampton,
Assistant Attorney General,
Philip R. Miller,
Joseph Kovner,
Kenneth R. Boiarsky,
Attorneys,
Department of Justice,
Washington, D. C. 20530

December 1971

Appendix

IN THE
UNITED STATES COURT OF CLAIMS

No. 35-71

D. B. ANDERS,
Plaintiff,

vs.

THE UNITED STATES OF AMERICA,
Defendant.

PLAINTIFF'S SUBMISSION PURSUANT TO
STANDARD PRETRIAL ORDER
(RULE 111)

Comes now the plaintiff by his attorney, Harlow B. King, and in compliance with Standard Pretrial Order on Liability filed herein June 7, 1971, submits the following:

1. (a) *List of documents.* The following documents are relied on and are to be offered in evidence:

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(2) Minutes of special meeting of the Board of Directors of Service dated May 12, 1961;

(3) Minutes of special meeting of the stockholders of Service dated May 12, 1961;

(4) Agreement of Sale dated May 16, 1961, between Service and Albert Gitlow, Abraham Gitlow, Ben E. Singer, and Joseph L. Fradkin, acting in behalf of Service Industrial Cleaners, Inc., a Missouri corporation formed by said Albert Gitlow *et al* on or about May 17, 1961, which corporation is hereinafter referred to as "Buyer";

(5) Restrictive Covenants Agreement dated May 17, 1961 between Buyer and D. B. Anders, an individual, the plaintiff, hereinafter referred to as "Anders";

(6) A second Restrictive Covenants Agreement dated May 22, 1961, between Buyer and Service;

(7) Bill of Sale from Service to Buyer dated May 22, 1961;

(8) "Memorandum Relating and Applying to Four Certain Agreements of Sale Entered Into Respectively Between D. B. Anders, Inc." et al dated May 22, 1961;

(9) Articles of Incorporation and all amendments thereto and Articles of Dissolution of Service;

(10) Statutory notice of liability mailed to Anders on July 7, 1964;

(11) Proof of payment by Anders as transferee on or about November 23, 1964, of a deficiency in Federal income tax of Service for its taxable year ended July 31, 1961, in the amount of $60,839.60;

(12) Statutory notice of disallowance of claim for refund in the amount of $60,839.60 dated March 2, 1970.

(b) A statement of material matters of fact about which it is believed that there is no substantial controversy:

(1) D. B. Anders is an individual residing in Overland Park, Kansas.

(2) Service was a corporation organized in March, 1949, under the laws of Missouri with its principal offices in Kansas City, Missouri. At all times material its stock was owned by Anders directly or through his nominees. By amendment filed May 17, 1961, Service's name was changed to D. B. Anders, Inc.

(3) Service timely filed a corporation income tax return for the fiscal year ended July 31, 1961, on an accrual basis with the district director of Internal Revenue at St. Louis, Missouri.

(4) Service was engaged in the business of conducting and providing a rental service of cleaned and laundered towels, seat covers, fender covers, wiping materials and dust cloths, coats, coveralls, shirts, pants, and other textiles and apparels, including dusting and wiping equipment, sweeping tools, mops, and accessories, herein referred to collectively as rental items, as well as conducting a cleaning and laundering service of substantially the same type of items owned by others, and in general conducting an industrial laundry business.

(5) For Federal income tax purposes Service charged to its expense accounts when purchased the cost of the rental items used in conducting its rental service business. At the end of each taxable year the

expense accounts were credited with the costs of the ending inventory of items which had not been placed in service at the end of the taxable year.

(6) In May, 1961, Anders reached an agreement for the sale of Service's business to a group of persons. The purchasers desired to carry on the business under a different corporation with the same name.

(7) On May 12, 1961, the board of directors and the stockholders of Service adopted resolutions approving and authorizing the sale of the corporation's properties and business, changing the corporate name to D. B. Anders, Inc. and adopting a plan of complete liquidation pursuant to the terms of Section 337 of the Internal Revenue Code of 1954.

(8) As of May 16, 1961, Service entered into an "Agreement of Sale" with Albert Gitlow, Abraham Gitlow, Ben E. Singer, and Joseph L. Fradkin, herein referred to as the purchasers, acting in behalf of Buyer.

(9) Under the agreement Service as "Seller" and the named individuals as "Purchasers" agreed to the sale and transfer to the purchasers or their assigns of all seller's inventory of the articles used in conducting the seller's rental service business, furniture and equipment, accounts receivable, interest in real property, name, routes, customers' patronage, and goodwill.

(10) The price was stated in the contract as follows:

Inventory of rental items	$116,000
Furniture and equipment	49,610
Sweeping tools, mops and accessories	1,000
Goodwill and customer patronage	50,000
Real property	63,000
Total	$279,610

In addition, there was to be paid a sum equal to the trade accounts receivable at the close of business May 17, 1961, and prepaid items as of that date.

(11) As of May 17, 1961, Anders entered into a covenant with the purchasers to refrain from competition with them or their corporation in the conduct of rental service or laundry business.

(12) As of May 22, 1961, Service, then known as D. B. Anders, Inc., entered into an agreement with the purchasers to a similar effect. As of the same date Service delivered to the buyer a bill of sale of certain assets. On or about May 22 or 23, 1961, the sale by Service of substantially all its assets to the buyer was completed.

(13) Pursuant to the plan of liquidation Service distribution all its assets in complete liquidation to petitioner, its sole stockholder, within the 12-month period beginning May 12, 1961.

(14) The corporation filed with the secretary of state of the State of Missouri its resolution of dissolution in March, 1962 and its corporate existence ceased.

(15) The corporation paid its Federal income taxes for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
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May 27, 1963	$ 3,998.61
November 23, 1964	60,839.60

(17) On its income tax return for the fiscal year ended July 31, 1961, the corporation reported a gain of $163,002.24 arising out of the sale of substantially all its assets to the buyer, and claimed exclusion of such gain from taxable income under Section 337, I.R.C. of 1954. The gain reported included $117,000 which was the amount of the consideration received by Service from Buyer allocated to the items-in-use in its laundry rental business.

(c) *Memorandum of Contentions of Fact and Law*

(1) *Contentions of Fact.* Plaintiff expects to establish the following ultimate material facts:

(i) On or about May 12, 1961, Service adopted a plan of complete liquidation pursuant to Section 337 of the Internal Revenue Code, and within the 12-month period beginning on the date of the adoption of the plan, distributed all its assets in complete liquidation to Anders, its sole stockholder.

(ii) Following the adoption of said plan of liquidation and pursuant to an agreement of sale entered into on or about May 16, 1961, Service did on May 22-23, 1961, sell, transfer and deliver to the Buyer in one transaction substantially all its assets, including the garments, shop towels, fender and seat covers, and dust control items in circulating use in Service's industrial laundry business.

(2) *Contentions of Law.* Plaintiff's case is based upon the following contentions of law:

(i) The garments, shop towels, fender and seat covers, and dust control items in use by Service in 1961 in its industrial laundry business constituted "property" within the intendment of Section 337 (b)(1) of the Internal Revenue Code of 1954.

I.R.C. 1954, 26 U.S.C.A. Sec. 337 (b)(1)

U. S. Treas. Reg., Sec. 1.337-3(a)

Malat v. *Riddell*, 383 U.S. 569, 571 (1966)

Jeanese, Inc. v. *United States*, 227 F. Supp. 304 (N.D. Cal. 1964), *rev'd. on other grounds*, 341 F.2d 502 (9th Cir. 1965)

D. B. Anders, 48 T.C. 815 (1967), *rev'd.* 414 F.2d 1283 (10th Cir. 1969), *cert. denied* 396 U.S. 958 (1969)

Frank W. Verito, 43 T.C. 429 (1965).

(ii) The May, 1961, transfer by Service to the Buyer of the garments, shop towels, fender, and seat covers, and dust control items then in circulating use in its industrial laundry business constituted a sale

or exchange within the intendment of Section 337 (a) of the Internal Revenue Code of 1954.

I.R.C. 1954, 26 U.S.C.A. Sec. 337 (a)

U. S. Treas. Reg., Sec. 1.337-2.

Commissioner v. *Brown*, 380 U.S. 563, 570-71 (1965)

Frank W. Verito, supra

George J. Aitken, 35 T.C. 227 (1960)

(iii) In the alternative, if the garments, shop towels, fender and seat covers and dust control items in circulating use by Service in its industrial laundry business did not constitute "property" within the intendment of Section 337 (b)(1) of the Internal Revenue Code of 1954, then they did constitute stock in trade or other property of a kind properly includible in inventory within the scope of Section 337 (b)(1)(A), and substantially all of said property was sold or exchanged to one person in one transaction within the intendment of Section 337 (b)(2), Internal Revenue Code of 1954.

I.R.C. 1954, 26 U.S.C. Secs. 337 (b)(1)(A) and 337 (b)(2).

U. S. Treas. Reg. Sec. 1.337-3(b).

Jeanese, Inc. v. *United States, supra.*

(d) (1) Plaintiff plans to call as witnesses the following:

(i) D. B. Anders, 8448 Valley View Drive, Overland Park, Kansas, formerly president of Service. Anders will testify as to the operation of Service's industrial laundry business, the rental of industrial

laundry items, the adoption of the Section 337 Plan of Liquidation, the sale to the Gitlow interests, and the liquidation of Service.

(ii) William E. Mangold, C.P.A., Power and Light Building, Kansas City, Missouri. Mangold will testify as to the accounting practice of Service, the reporting of the sale to the Gitlow interests on Service's final corporate income tax return, and the final distributions of assets at date of liquidation.

In the alternative, there is the possibility that the case can be submitted entirely upon a written stipulation of facts, if all the necessary facts can be mutually agreed upon by the parties.

(2) The preferred date for the beginning of the trial is on or about December 1, 1971, and the preferred place is Kansas City, Missouri.

(3) It is estimated that approximately four (4) hours total time will be required for direct examination of plaintiff's witnesses.

Respectfully submitted,

/s/ Harlow B. King
Harlow B. King
Attorney for Plaintiff

Of Counsel:
J. Glenn Hahn
Walter J. Kennedy

APPENDIX E-2

Plaintiff's Response to Defendant's Motion for Summary Judgment and Supporting Brief

IN THE
UNITED STATES COURT OF CLAIMS

Docket No. 35-71

D. B. ANDERS,
Plaintiff,

vs.

THE UNITED STATES OF AMERICA,
Defendant.

PLAINTIFF'S RESPONSE TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Comes now the Plaintiff D. B. Anders, pursuant to Rule 52 of the Rules of the United States Court of Claims and respectfully moves the Court to overrule the motion for summary judgment heretofore filed by the Defendant herein for the following reasons:

1. There are genuine issues of fact in this case;
2. The decision relied upon by Defendant, *Commissioner* v. *Anders*,* 414 F.2d 1283 (10th Cir. 1969) is

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*Incorrectly cited by Defendant throughout its Motion For Summary Judgment and Brief in Support Thereof (filed herein on December 21, 1971, hereafter cited as Defendant's Brief) as *Anders* v. *Commissioner* (*sic*).

clearly erroneous and should not govern the decision of this Court; and

3. Defendant is not entitled to judgment as a matter of law;

WHEREFORE, Plaintiff prays that Defendant's motion for summary judgment be overruled.

Respectfully submitted,

Harlow B. King
Attorney for Plaintiff

Of Counsel:
J. Glenn Hahn
Walter J. Kennedy
February, 1972.

Brief in Support of Plaintiff's Response to Defendant's Motion for Summary Judgment

This is a suit for the recovery of federal corporate income taxes for the taxable year ended July 31, 1961, in the amount of $60,839.60 and assessed interest of $10,961.12, or a total of $71,800.72, plus statutory interest thereon, such amount having been duly paid by plaintiff as transferee of the assets of D. B. Anders, Inc. (formerly Service Industrial Cleaners, Inc.), a Missouri corporation now dissolved, which had its principal place of business at 3612 East 27th Street, Kansas City, Missouri (hereinafter referred to as "Service").

QUESTIONS PRESENTED

1. Did the garments, shop towels, fender and seat covers, and dust control items in circulating use by Service in 1961 in its industrial laundry business constitute "property" within the intendment of Section 337(b) (1) of the Internal Revenue Code of 1954?

2. Did the May, 1961 transfer by Service to the Buyer of the garments, shop towels, fender and seat covers, and dust control items then in circulating use in its industrial laundry business constitute a "sale or exchange" within the intendment of Section 337(a) of the Internal Revenue Code of 1954?

3. In the alternative, if the garments, shop towels, fender and seat covers, and dust control items in circulating use by Service in 1961 in its industrial laundry business constituted stock in trade or other property of a kind properly includable in inventory or property held pri-

marily for sale to customers within the scope of Section 337(b) (1) (A), was substantially all of said property sold or exchanged to one person in one transaction within the intendment of Section 337(b) (2)?

4. If the gains realized by Service in 1961 from the sale of the garments, shop towels, fender and seat covers, and dust control items constitute gains from the sale or exchange of property within the intendment of Section 337, does the "tax-benefit" rule require that such gains be taxed as income to the corporation notwithstanding the express provisions of Section 337?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in Appendix A, *infra*.

STATEMENT

Plaintiff does not dispute the evidentiary matters set out in the Statement (of Facts) appearing in Defendant's Brief.[1] Plaintiff does contend that there are genuine issues of ultimate fact and conclusions of law, as set out herein under "Questions Presented", *supra*. Further, plaintiff wishes to reiterate that the instant case relates to taxes paid by the plaintiff *as transferee of the assets of D. B. Anders, Inc.* (formerly Service Industrial Cleaners, Inc.), a *Missouri* corporation; the instant case constitutes a clearly separate and distinct cause of action from that involved in the case relied upon by defendant in support of its Motion for Summary Judgment, *Commissioner* v. *Anders*, 414 F.2d 1283 (10th Cir. 1969), hereinafter sometimes referred to as the "Kansas" case.

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1. See Appendix E-1, pp. A38-A40.

ARGUMENT

I. There are Genuine Issues of Fact in This Case.

Plaintiff has set forth above under "Questions Presented", *supra*, the issues of fact in this case. In its opinion in the Kansas case (filed September 6, 1967), the Tax Court of the United States answered substantially identical questions in favor of the taxpayer therein, saying to the first two:

> "On the basis of these facts, it appears that there was literal compliance with the requirements of section 337(a), and further, not being property specifically excluded by section 337(b) (1), that the rental items involved were property, the gain or loss from the sale of which is not to be recognized to the corporation under section 337(a). See sec. 1.337-3, Income Tax Regs.; Rev. Rul. 59-120, 1959-1 C.B. 74." 48 T.C. at 819.

To the last, which it was not required to answer because of its holding on the first two, the Tax Court observed:

> "In this connection, it is to be noted that had the rental items-in-use been inventoried, sec. 337(b) (2) would have required the nonrecognition of gain to the corporation." 48 T.C. at 823 n 5.

In order to remove any possibility of confusion in this case on the issue[2], plaintiff here wishes to reiterate its al-

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2. In the Kansas case the Tax Court opinion made the erroneous observation in its statement of facts: "They (the parties) further agree that the rental items involved were not stock in trade, property includable in inventory, or property held by the corporation for sale to customers in the ordinary course of its trade or business." 48 T.C. at 819. The Tax Court in note 5, *supra*, however, clearly set out its interpretation of the applicable

ternative position as to the issue set forth as paragraph 3 under "Questions Presented", *supra*. It is plaintiff's *alternative* position that the rental items constituted stock in trade or property includable in inventory or property held primarily for sale to customers. If they are none of these, then by the language of defendant's own regulations, they perforce are "property" within the intendment of Section 337(b) (1) of the Internal Revenue Code of 1954. Treas. Reg. § 1.337-3(a).

The last issue, the applicability of the tax-benefit rule in contravention of section 337, was also squarely before the Tax Court in the Kansas case. The Court stated the issue succinctly:

> "On brief, respondent states that he 'relies on the well established rule that if an amount deducted from gross income in one taxable year is recovered in a later year, the recovery is income in the later year.' The rule referred to is commonly known as the tax-benefit rule or doctrine." 48 T.C. at 819-820.

Footnote continued—

law. Counsel for taxpayer did not move to correct the language in the Tax Court opinion because the decision by the Court held squarely for the taxpayer on his principal premise, making the alternative contention irrelevant.

In its original typewritten opinion (p. 3) in the Kansas case, the Tenth Circuit reiterated the erroneous Tax Court statement, notwithstanding that it was patently clear from the taxpayer's brief before that Court that this was a principal, albeit alternative position of the taxpayer. *Commissioner* v. *Anders*, *supra*, Brief for Respondent, p. 14. When this fact was pointed out in taxpayer's Petition for Rehearing, the Circuit Court passed it off perfunctorily. 414 F.2d at 1289. On petition for certiorari counsel for defendant, through inadvertence or otherwise, did his part to perpetuate the obvious inaccuracy by repeating in his brief the misstatement contained in the language of the typewritten Tenth Circuit opinion, *loc. cit. supra*, even though it was subsequently withdrawn by that Court. *Anders* v. *Commissioner*, 396 U.S. 958 (1969), Brief for The Respondent in Opposition, p. 3 n. 1.

The Tax Court's answer is equally precise:

> "Where, as here, application of the tax-benefit rule would *contravene the clear and unambiguous provisions of section 337 (a)*, we think it should *not* be applied." 48 T.C. at 821 (*italics added*).

More than four years have elapsed since the Tax Court's issuance of its opinion in *D. B. Anders* v. *Commissioner, supra*. Despite the subsequent reversal of its decision by the Tenth Circuit on June 20, 1969, no opinion of the Tax Court issued since that date has given any indication that it has in any way changed, modified or altered its opinion on the legal issues herein.[3] Under such circumstances the conflict of authority between the Tax Court and the Tenth Circuit clearly remains.

II. The Tenth Circuit Decision in *Commissioner* v. *Anders* is Clearly Erroneous and Should Not Govern the Decision of This Court.

The history of defendant's position on the legal issues herein has been a long and tortuous one, embracing now one theory, then another, subject only to the interpretation that ostensibly the Government was entitled to more tax revenues, right or wrong.[4] The opinion of the Tenth

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3. The absolute void of litigated cases in the Tax Court on this issue in the past four and one-half years raises the conjecture that this may have been by design, rather than mere happenstance.

4. This can perhaps best be exemplified by the artifice which surrounded the handling by the appellate court of the issue in the Kansas case surrounding Treas. Reg. § 1.162-3, which deals with the expense deduction for incidental expendable supplies. Although the applicability of this regulation was not raised by the Commissioner at any time by pleadings, argument, or brief, before the Tax Court and despite the fact that the Tax Court had clearly found that the deduction issue was governed by Treas. Reg. § 1.446-1(c)(iv) and § 1.471-1, counsel for the Commissioner in his brief before the Tenth Circuit adroitly inserted a

Circuit in the Kansas case, a monument of legerdemain, avoids rather than answers the common Questions Presented there and here. This Court can and should address itself squarely to the issues presented herein, independently of such albatross.

A. The Garments, Shop Towels, Fender and Seat Covers, and Dust Control Items Constitute "Property" Within the Intendment of Section 337(b)(1).

The answer to the first *Question Presented, supra,* is clearly in the affirmative—the garments, shop towels, fender and seat covers *do* constitute property within the meaning of section 337(b)(1). The Tax Court specifically

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Footnote continued—

footnote reading in part "The deduction of materials and supplies as expenses is covered by Section 1.162-3 of the Treasury Regulations on Income Tax (26 C.F.R. Sec. 1.162-3) . . ." Brief for the Petitioner, p. 15 n. 8. This was clearly irrelevant to the issues at hand and no one could have known that better than the Commissioner. But the Tenth Circuit, in its misguided zeal, made the following statements concerning the applicability of Treas. Reg. § 1.162-3 in its original typewritten opinion:

> "For Federal income tax purposes Service charged the full cost of the rental items described to expense accounts when purchased pursuant to Treasury Regulation § 1.162-3 as a cost of materials and supplies." (p. 2).
>
> • • •
>
> "The rental items in question had a zero basis and their cost had been fully expensed on purchase by Service in its Federal income tax return under Treasury Regulation § 1.162-3 (p. 8)."

When counsel for the taxpayer pointed out in his Petition for Rehearing that the Court had erred in making such statements, the response was, "Accepting the proposition that Treasury Regulation § 1.162-3 was *not* the basis of the taxpayer's expense charges, *the result is the same.*" 414 F.2d at 1289 (*italics added*). Nonetheless, the Court, somewhat red-faced no doubt, withdrew pages 2, 3, and 8 of its original 12-page opinion and substituted three new pages which appeared as the official opinion, thereby burying forever its obvious confusion as to what the case was all about.

so held in the Kansas case[5] and defendant itself here states that case involved "a substantially identical factual setting".[6]

The opinion of the Tenth Circuit in the Kansas case on this question, as on others at issue, could most charitably be said to equivocate. Compare these statements made in sequence in the opinion, as they appear in juxtaposition:

(1)	(2)	(3)
"*The fact that a transaction involves disposition of property* does not compel treatment of the proceeds as gain from such a transfer." 414 F.2d at 1288 (*italics added*).	"Instead, we conclude that tax benefit principles call for treatment of the proceeds *not as gain from the sale of property, but as ordinary income which was deducted on its purchase.*"[7] *Ibid* (*italics added*).	"As the opinion stated, we conclude that *the fact that a transaction involves the disposition of property within the meaning of* § 337. . . ." Order Denying Petition for Rehearing, 414 F. 2d at 1289 (*italics added*).

Yes, the transaction involves a disposition of *property*; the garments, shop towels, fender and seat covers, and dust control items *are property*. No, on second thought, the garments, shop towels, fender and seat covers, and dust control items are *not property*; they are *income*

5. See 48 T.C. at 819, quoted at p. A56, *supra*.

6. Defendant's Brief, p. A40.

7. The phrase "ordinary income which was deducted on its purchase" has no logical legal connotation with respect to the Internal Revenue Code of which plaintiff is aware.

(sic)! But on the other hand, they *are property* within the meaning of § 337.[8] Grasp it now, ere like Saint Nick, it fades out of sight! What kind of machinations are these?

Apparently the Tenth Circuit did not feel that the taxpayer in the Kansas case was entitled to a definitive answer as to whether the rental items did in fact constitute property. In the absence of any statement by the Tenth Circuit that the Tax Court finding that the rental items *did* constitute property was clearly erroneous, however, it appears reasonable to conclude that the findings of fact of the Tax Court on this issue were not set aside by the Tenth Circuit. Indeed, the Tenth Circuit could have no reasonable grounds for so doing.[9] The rental items there and here were property.

B. The Transfer by Service to Buyer on May 22-23, 1961 of the Garments, Shop Towels, Fender and Seat Covers, and Dust Control Items in Use in Service's Industrial Laundry Rental Business Constituted a "Sale" of Said Property.

The answer to the second *Question Presented, supra,* is likewise in the affirmative. The transaction in question constituted a sale. The Tax Court opinion in the Kansas case clearly so held.[10] As a matter of fact, the Reply Brief for Respondent in the Tax Court case was equally to the point:

> "Respondent does not question the fact that a sale took place."[11]

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8. Perhaps they were property, but there was no sale? See paragraph B, *infra*.

9. The findings of the Tax Court are subject to the protection of Rule 52(a) of the Federal Rules of Civil Procedure by reason of 26 U.S.C. § 7482.

10. 48 T.C. at 819.

11. Reply Brief for Respondent, p. 6.

It seems a simple enough question. Did a sale of property occur? And the answer of the fact-finding body was straight-forward enough. But the Tenth Circuit could never quite bring itself face to face with the question.

What did the Tenth Circuit have to say? Was there a sale or wasn't there? No one can tell with certainty, but perhaps that was the whole idea. Some idea of the difficulties encountered by that Court in upholding its house of cards can be gathered from a comparison of the following language appearing from time to time throughout its opinion and Order Denying Petition for Rehearing:

* * *

> "The issue involved is whether the amount received for rental items of apparel, towels and the like in a *sale* of corporate assets. . . ." 414 F.2d at 1284.

* * *

> "On May 22 and 23 the rental items in question and substantially all of Service's assets *were sold* to the purchasers." 414 F.2d at 1285.

* * *

> "It is this gain from disposition of the rental items in use. . . ." *Ibid.*

* * *

> "If . . . the tax benefit rule and similar principles would have made the proceeds from the *sale* of such property. . . ." 414 F.2d at 1287.

Certainly sounds like a sale to this point, doesn't it? But now the fancy work begins as "We turn to a consideration of this case under tax benefit principles":[12]

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12. 414 F.2d at 1287.

> "The rental items in question had a zero basis and their cost had been fully expensed on purchase by Service in its Federal income tax returns and deductions were taken therefor by Service. In similar circumstances (*sic*) a *recovery* of *property* by the taxpayer. . . ." 414 F.2d at 1287 (*italics added*).

That the case cited by the Court in support of this premise, *Alice Phelan Sullivan Corporation* v. *United States*, 381 F.2d 399 (Ct. Cl. 1967), involved not a sale at all of any kind but a *reconveyance* to the taxpayer of two parcels of realty which it had previously *donated* and claimed as a charitable deduction deterred the Court not at all. A sale is "similar" to a charitable contribution? How?

The Court next observes that:

> "Under such (tax benefit) principles the *proceeds* of the rental items *should* properly *be treated as recoupment* of the expense charges." 414 F.2d at 1287-1288 (*italics added*).

That the cases there cited in support of its conclusion are obviously not in point[13] is ostensibly irrelevant.

Was there a sale? Why, yes, there was "[*A*] *sale of corporate assets*. . . ." (414 F.2d at 1284); "[S]ubstantially all of Service's assets *were* sold. . . ." (414 F.2d at 1285); "[T]he proceeds from *the sale*. . . ." (414 F.2d at 1287). Well, now, maybe there was not. Does the omission of the words "of sale" after the word "proceeds" appearing in the phrase cited above[14] have some legal significance? Or is it mere sleight-of-hand? Why were the "proceeds of

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13. A cold hard fact which the Court finally comes to grips in its concluding paragraph. See p. A67, *infra*.

14. "Under such (tax benefit) principles the *proceeds of the rental items*. . . ." 414 F.2d at 1287.

the rental items" any different from the "proceeds" of the real property or the "proceeds" of the furniture and equipment? Can it be said that the taxpayer "recouped" the real property when he sold it for cash and notes?

Here again the Tenth Circuit could apparently not reach a yes-or-no answer to the question was there a sale. And again in the absence of any definitive statement by the Tenth Circuit that the Tax Court findings of fact on this question were clearly erroneous, the only reasonable conclusion which can be drawn is that the findings of the Tax Court on this issue were not set aside. There *was* a sale of the rental items.

C. In the Alternative, If the Garments, Shop Towels, Fender and Seat Covers, and Dust Control Items in Use in Service's Industrial Laundry Rental Business Constitute Stock in Trade, Inventory, or Property Held Primarily for Sale, Substantially All of Said Property Was Sold to One Person in One Transaction.

It is plaintiff's primary contention, as set forth previously herein, that the assets in question constitute property as defined by Section 337(b)(1). If it is determined, however, that the assets fall within the exclusions of Section 337(b)(1)(A), it is respondent's alternative contention that the gain must nonetheless be excluded from taxable income under Section 337 because all the assets in question were sold to one person in one transaction, and hence, the assets constitute property as defined in Section 337(b)(2).

Section 337(b)(2) states that if substantially all the property described in Section 337(b)(1)(A), *i.e.*, stock in trade, inventory, or property held primarily for sale to customers, which is attributable to a trade or business of the corporation, is sold or exchanged to one person in one trans-

action, for purposes of Section 337(a), the term "property" includes such property so sold or exchanged, and installment obligations acquired in respect of such sales or exchanges. This exception for bulk sales of inventory was added by the Senate so that Section 337 "more nearly corresponds to the results that would follow a sale of all the corporate assets (including the inventory) and the sale of all the stock." S. Rep. No. 1622, 83rd Cong., 2nd Sess., 1954, U.S. Code Cong. & Adm. News 4621, at 4680.

There is no dispute with respect to the facts here applicable. Service sold to one person the corporation formed to acquire such assets, in one transaction, substantially all the assets of its industrial laundry rental business, including its "entire inventory" of garments, shop towels, covers, and dust control items (R. 37, 38, 188). Hence, even if it is assumed, arguendo, that the assets in question are property of the type described in Section 337(b)(1)(A), all of such assets were sold to one person in one transaction and hence they are included in the definition of the term "property" by the force of Section 337(b)(2). The Tax Court so observed in the Kansas case. See *Jeanese, Inc.* v. *United States,* 341 F.2d 502 (9th Cir. 1965), *reversing* 227 F.Supp. 304 (N.D. Cal. 1964).

Did the Tenth Circuit opinion in the Kansas case answer the taxpayer on this issue? Not exactly. Forced to deal with it after the taxpayer's Petition for Rehearing called to the Court's attention that it had "erroneously failed to give any consideration whatsoever to the alternative position of the Respondent in this case,"[15] the Court laconically observed:

"As the opinion stated, we conclude that the fact that a transaction involves a disposition of property within

15. Petition for Rehearing p. 3.

the meaning of § 337 does not compel treatment of the proceeds of it as gain from a transfer of the property. The same reasoning applies if the property is treated as within the meaning of § 337(b)(2)." 414 F.2d at 1289.

Hence, the only reasonable conclusion to be drawn is "perhaps" the rental items in question constitute property within the meaning of § 337(b)(2) and "perhaps not". If the answer is no, then by the defendant's own regulations, they must constitute "property" within the intendment of section 337(a).[16] If the answer is yes, then the sale is also within Section 337. No wonder the Court sought to sidestep the Commissioner's dilemma.

D. The Gains Realized by Service from the Sale of the Garments, Shop Towels, Fender and Seat Covers, and Dust Control Items Constituting Gains from the Sale of Property Within Section 337, the Tax Benefit Rule Does Not Require That Such Gains Be Taxed As Income to the Corporation; to Do So Would "Contravene the *Clear and Unambiguous* Provisions of Section 337(a)."

Despite the intricate maneuvering and grammatical sleight-of-hand by the Commissioner and the Tenth Circuit in the "substantially identical factual situation" of the Kansas case, the answers to the first three questions there and here presented rise clearly above the contrived confusion. *Yes*, there was a *sale* of *property* by Service *within the intendment of Section 337*. This leaves only the last issue, do "tax-benefit principles" require that gains from such sale be taxed to the corporation even though to do so would as the Tax Court said, "contravene the clear and unambiguous provisions of Section 337(a)"[17]? For all

16. Treas. Reg. Sec. 1.337-3(a).

17. 48 T.C. at 821.

its citations of authority, even the Tenth Circuit at last observed:

> "As the taxpayer says, *the controversy is not clearly decided by any of these cases.*" 414 F.2d at 1288 (*italics added*).

And plaintiff submits that the conclusion there reached by the Tenth Circuit was clearly erroneous.

What were "these cases" and why was the Tenth Circuit led to amend judicially Section 337 of the Internal Revenue Code? Its rationale is not easily followed. The position of the Commissioner of Internal Revenue in his brief and oral argument before the Tenth Circuit, even though much of it was not reflected specifically in the final opinion of the Tenth Circuit, apparently confused that Court as to the true issues in that case, as an analysis and comparison of the Commissioner's briefs in the two jurisdictions clearly illustrates:

Each of the legal authorities relied upon by the Commissioner in his briefs in the Tax Court were clearly and adequately distinguished by the Tax Court in its opinion. Revenue Ruling 61-214, 1961-2 Cum. Bull. 60, which was the start of the whole thing, the Commissioner's initial attempt to amend Section 337, received this comment from the Tax Court:

> "The conclusions reached are not supported by the authorities cited therein, are clearly contrary to the provisions of Section 337(a) and, in our opinion, are not a valid interpretation of the statute." 48 T.C. at 822.

One of the cases cited in Revenue Ruling 61-214, *Commissioner* v. *First State Bank of Stratford*, 168 F.2d 1004 (5th Cir. 1948), *reversing*, 8 T.C. 831, *cert. denied* 335 U.S. 867, was disposed of by the Tax Court in short order:

> "The Court of Appeals held the bank taxable under the anticipatory assignment of income rule. Obviously, Section 337, enacted some 6 years later, was not involved, nor was there a 'sale or exchange' of property in partial or complete liquidation." 48 T.C. at 822.

Central Building & Loan Association, 34 T.C. 447 (1960) was likewise distinguished by the Tax Court on the grounds that there was no sale or exchange, but rather a collection of interest. The absence of a sale or exchange was also noted by the Tax Court in *West Seattle National Bank of Seattle*, 33 T.C. 341 (1959), *aff'd* 288 F.2d 47 (9th Cir. 1961), and *J. E. Hawes Corp.*, 44 T.C. 705 (1965), both of which held that Section 337 did not apply to the restoration of bad debt reserves to income, following the sale of the accounts receivable to which they related.[18] To *Commissioner* v. *Kuckenberg*, 309 F.2d 202 (9th Cir. 1962), *modifying* 35 T.C. 473 (1960), *cert. denied* 373 U.S. 909 (1963) and *Pridemark, Inc.* v. *Commissioner*, 345 F.2d 35 (4th Cir. 1965), *aff'g. and rev'g.* 42 T.C. 510 (1964), the Tax Court replied that the sales of completed contracts there were anticipatory assignments of earned income, assignment of income cases patently were not applicable to the facts in the Kansas case. As a matter of fact the Tax Court appraised the Commissioner's entire position with admirable candor:

> "Neither of these two cases which were cited in Rev. Rul. 61-214, support the ruling or respondent's contention with respect to the application of the tax-benefit rule in a complete liquidation under section 337. *Nor do any of the other cases cited by respondent on brief.*" 48 T.C. at 822 (*italics added*).

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18. Has the holding of these cases been overruled by *Nash* v. *United States*, 398 U.S. 1 (1970)? See p. A72, *infra*.

From what course came the reversal of the Tenth Circuit? The opinion first recites the purported Congressional intent in enacting Section 337, *i.e.*, to deal with the so-called *Court Holding Co.*[19] problem; the purpose was to eliminate the incurring of a double tax, one at the corporate level and one at the shareholder level. The Court noted:

> "And the means employed was to provide for non-recognition of the gain to the corporation on the sale of property (as defined in § 337) by it before its liquidation." 414 F.2d at 1287.

The Court conveniently fails to discuss the fact that the result of its reversal of the Tax Court decision in the Kansas case is to impose a tax upon the corporation as well as upon the shareholder; that the tax upon the corporation would not have been incurred if the corporation had been first liquidated and the sale of its assets, including the rental items in question, been made by the stockholder individually. In other words, the result of the Tenth Circuit reversal is to *impose* a double tax; the clearly stated Congressional intent was to *eliminate* one. So how did the Court come by its reversal?

The Court next turns to speculate[20] the Congressional intent concerning the applicability of "tax-benefit principles" in cases under Section 337. It stated its conclusion with great brevity:

> "The statute used a definition of property in § 337 parallel to that of assets (*sic*) in § 1221 of the 1954

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19. 324 U.S. 331 (1945), and its companion case, *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950).

20. And speculation is all that it is since neither the Senate nor the House report even mentions "tax-benefit", let alone suggest how it should apply to Section 337. See S. Rep. No. 1622, 83d Cong., 2d Sess. 258 (1954); H. R. Rep. No. 1337, 83d Cong., 2d Sess. A106 (1954).

Code.[21] Moreover, there is no provision in the statute showing an intent to alter or bar the application in cases under § 337 of tax-benefit principles fashioned under other provisions of the Code. Therefore, we conclude that tax benefit principles are applicable here as under other statutory provisions and that § 337 intended no disregard of them in liquidation cases." *Ibid.*

This is purely the arbitrary conclusion of the Court, unsupported by legal authority. True enough, the opinion says, "See *Citizens Federal Savings & Loan Association of Cleveland*, 290 F.2d 932, 154 Ct. Cl. 305 (1961) and *West Seattle National Bank of Seattle* v. *Commissioner*, 288 F.2d 47 (9th Cir. 1961)"[22], but the Court's reasoning for the prefatory "see" is obvious enough.[23]

The *Citizens Federal Savings & Loan* case clearly involves the same issue as *West Seattle National Bank of Seattle*, whether the credit balance in a bad debt reserve account is required to be credited to income in the year in which the need for the reserve ceases, and if so whether the credit to income is exempt from tax if the corporation has duly adopted a Section 337 plan of liquidation.

The irony of the Tenth Circuit's reliance upon *West Seattle* lies not only in the fact that the Tax Court opinion in the Kansas case pointed out clearly that *West Seattle*

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21. This foretells the gymnastics to come upon its second conclusion.

22. 414 F.2d at 1287.

23. The signal word "see" indicates that the cited authority constitutes basic source material supporting an opinion or conclusion of either law or fact drawn in a textual statement. It indicates that the asserted opinion or conclusion will be *suggested by* an examination of the cited authority rather than that the opinion or conclusion is *stated by* the cited authority. *A Uniform System of Citation* 87 (11th ed. 1967) (*italics added*).

did not involve any gain from the *sale* of assets, but also in the fact that the Ninth Circuit's opinion in *West Seattle affirms* the decision of the Tax Court below, 33 T.C. 341 (1959)! The Tax Court opinion in *West Seattle* is straightforward and squarely to the point:

> "The income here sought to be taxed did not arise from the sale of assets. The only relation the sale of petitioner's assets had to this income is that it removed the necessity for maintaining the reserve for bad debts because petitioner no longer held receivables, the full collection of which might be doubtful." 33 T.C. at 344.

And with respect to the nature of the item being dealt with the Tax Court further observed:

> "As we stated in *Geyer, Cornell & Newell, Inc., supra*, a reserve for bad debts consists of entries upon books of account. It is neither an asset nor a liability. . . . Unlike an asset or liability it cannot be transferred to any other entity . . ." *Ibid.*

The decision of the Tax Court in *West Seattle* was *affirmed* by the Ninth Circuit, not reversed, and the insertion by the Tenth Circuit of language from the Ninth Circuit opinion out of context[24] clearly fails to support the premise for which it is cited since a bad debt reserve is something which by its very nature cannot be sold or transferred.

Citizens Federal Savings & Loan, supra, relies heavily upon the Tax Court opinion in *West Seattle* and cites the

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24. "* * * increment realized in *this area* over and beyond adjusted basis does not then represent any gain in capital or asset value." 288 F.2d at 49, cited at 414 F.2d 1287. "This area", read in context, clearly refers only to "a bad debt recovery." 288 F.2d at 49.

language above quoted, *"The income here sought to be taxed did not arise from the sale of assets."* 290 F.2d at 936.[25] Hence, the Court's initial premise in the Kansas case is obviously incorrect. The bad debt reserves in *Citizens* and *West Seattle* were taxed not because the tax benefit rule applies to Section 337, but because by the Court's own words, *there was no sale.*

In a recent decision of the United States Supreme Court in *Nash* v. *United States*, 398 U.S. 1 (May 18, 1970), which was subsequent to the Tenth Circuit decision in *Anders* (June 20-August 6, 1969), the Court there held that although the "need" for a bad debt reserve had ended with the transfer of the accounts receivable to several corporations pursuant to Section 351 of the Internal Revenue Code, the end of that need did not mean a "recovery" within the meaning of the so-called "tax-benefit rule". As the court said, it was there dealing with § 351(a) of the Code which provided specifically for the nonrecognition of gain under the circumstances there described, just as here we are dealing with a similar provision in Section 337. Plaintiff submits that the effect of the holding in the *Nash* case is to overrule the holdings in *West Seattle National Bank* v. *Commissioners, supra,* and *Citizens Federal Savings & Loan, supra,* concerning the treatment of bad debt reserves in a Section 337 liquidation. *Citizens Acceptance Corporation* v. *United States*, 320 F. Supp. 798, 804 (D. Del. 1971). This being the case the Tenth Circuit's opinion in *Commissioner* v. *Anders, supra,* which purports to be based thereon, should, plaintiff submits also be deemed to be overruled by *Nash.*

Nor does the Tenth Circuit's second premise withstand scrutiny any better. The Court observes further:

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25. Cf. *Perry* v. *United States*, 160 F. Supp. 270 (Ct. Cl. 1958).

"Under such (tax benefit) principles the proceeds of the rental items should properly be treated as recoupment of the expense charges." 414 F.2d at 1287-1288.

But its authorities[26] support no such conclusions. Most have already been distinguished herein previously.[27] As for the remainder, they are equally inapropos. *Merchants National Bank of Mobile* v. *Commissioner*, 199 F.2d 657 (5th Cir. 1952) obviously has nothing to do with Section 337, having been decided two years prior to its enactment and involving the taxable year 1944. In any event the issue is whether the amounts received from the sale of notes receivable charged off to bad debts in an earlier year constitute ordinary income or capital gain. Protestations thereof by the defendant herein notwithstanding, this is not and has never been the issue in the Section 337 case[28] such as this. *William Eugene Monday, Jr.*, 16 TCM 1 (1957), *affirmed per curiam*, 252 F.2d 789 (6th Cir. 1958), *cert. denied*, 358 U.S. 883 (1958) involves two issues, one on ordinary income v. capital gain on the sale of defense housing units and another on the taxation of mortgagee's escrow accounts; neither the tax benefit rule nor Section 337 are remotely involved. No serious contention can be made that *Lloyd H. Faidley*, 8 T.C. 1170 (1947), involves a sale of any variety; obviously it does not involve Section 337.

The Court's last premise, representing an entirely new approach by the Commissioner from the Tax Court to the

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26. Again preceded by "see". See n. 23, *supra*.

27. *Alice Phelan Sullivan Corporation* v. *United States, supra; Citizens Federal Savings & Loan Association of Cleveland* v. *United States, supra; West Seattle National Bank of Seattle* v. *Commissioner, supra; Commissioner* v. *First State Bank of Stratford, supra.*

28. See the plaintiff's statement of its alternative position herein, p. 13, *supra.*

Appellate Court, is not at once apparent from the opinion of the Tenth Circuit, though developed at somewhat greater length by the Commissioner's brief and oral argument.[29] Briefly stated the Commissioner's "new theory" was to the effect that:

(1) the tax benefit rule is an exception to the capital gains statute, I.R.C. 1954, Section 1221;

(2) the definition of capital asset in Section 1221 is substantially the same as the definition of property in Section 337 (b);

(3) therefore, the tax benefit rule is applicable to Section 337.

The difficulty with this premise is two-fold: the tax benefit rule is *not* an exception to the capital gains statute; and whether or not the rental items in question were capital or non-capital assets is, they were property so long as all assets were sold to one purchaser in one transaction. Whether such premise was actually accepted by the Court is difficult to tell:

> "The fact that a transaction involves disposition of property does not compel treatment of the proceeds as gain from such a transfer. Commissioner v. Gillette Motor Co. (sic), 364 U.S. 130, 134 . . . United States v. Eidson, 310 F.2d 111, 113-114 . . ." 414 F.2d at 1288.

The issue in *Gillette Motor Transport* was clearly whether amounts received by the taxpayer from the government as compensation for the temporary taking by the government of the carrier's business facilities during World War

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29. Including a totally-unexplainable citation to *Corn Products Ref. Co.* v. *Commissioner*, 350 U.S. 46 (1956), *rehearing denied*, 350 U.S. 943 (1956).

II represented ordinary income or capital gain within the meaning of I.R.C. 1939, § 117(j) (I.R.C. 1954, § 1221). The property in question was the right to determine freely what use to make of the taxpayer's transportation facilities. The Supreme Court did not hold that such right was not property; to the contrary, it said to the taxpayer's contention that it had been deprived of *property*, "That is indeed true." 364 U.S. at 133. What it did hold was that while the right was property, it was simply not a capital asset. Amounts received therefor were ordinary income. *Gillette Motor Transport* clearly does not support the premise for which it is cited by the Tenth Circuit, and that Court's failure to make reference to the only real issue in *Gillette* can hardly contribute to a sound solution to the problem at hand. One has only to read the citation in the *Eidson* case to realize that *Gillette* is authority simply for the proposition, "[W]hat has many times been made clear by the Supreme Court - - - it is not every transfer for a consideration of property that gives rise to *a capital gain*." 310 F.2d at 113. Certainly, *Gillette* has nothing to do with tax benefit principles.

Whether or not the rental items in issue were capital assets, they were clearly "property" within the meaning of Section 337(b) and the regulations thereunder. And there was clearly a sale. It is submitted that the decision of the Tenth Circuit in *Anders* v. *Commissioner* is clearly erroneous, is not supported by the authorities cited therein, and should not be determinative of the decision of this Court herein.

III. Defendant Is Not Entitled to Judgment As a Matter of Law; Its Motion for Summary Judgment Should Be Denied.

Defendant has here filed a Motion for Summary Judgment pursuant to Rule 101 of the Rules of this Court.

Since this rule is substantially the same as Rule 56 of the Federal Rules of Civil Procedure, the practice and interpretation of Rule 56 in the Federal District Court should be here considered by this Court. *Love* v. *United States*, 104 F. Supp. 102 (Ct. Cl. 1952).

It is axiomatic that if a genuine issue of material fact exists in a dispute, the case cannot be ripe for disposition by summary judgment. *Washington* v. *Cameron*, 411 F.2d 705 (D. C. Cir. 1969). The burden of proving that there is no genuine issue as to any material fact is here on the defendant, the moving party. In sustaining his burden, defendant must demonstrate *positively and clearly* that there is no genuine issue of fact, and any doubt as to the existence of such issue must be resolved against the moving party. *2361 State Corp.* v. *Sealy, Inc.*, 402 F.2d 370 (7th Cir. 1968). The inferences to be drawn from the underlying facts contained in defendant's motion herein must be viewed in the light most favorable to plaintiff, the opposing party. *Adickes* v. *Kress & Co.*, 398 U.S. 144 (1970).

There were three specific issues of fact in the Kansas case: Did the rental items constitute property within the meaning of Section 337(b)? If the rental items did not constitute property as defined by Section 337(b)(1) and the regulations thereunder, did they constitute property within the inventory exception of Section 337(b)(2)? Was there a sale or exchange of property within Section 337(a)? In the Kansas case the Tax Court determined each of these issues of fact in favor of the taxpayer; the holding of the Tenth Circuit with respect thereto can most charitably be said to be "unclear". In any event, the Tenth Circuit is not, or should not be the finder of facts in any case. Under such circumstances, how can defendant seriously contend that no genuine issue of fact exists here?

As plaintiff has pointed out at length earlier, the Tenth Circuit decision in *Anders* v. *Commissioner* is clearly erroneous. And the other cases cited by defendant in his motion add nothing to the rational solution of the issue.[30] Further, plaintiff submits that the Supreme Court decision in *Nash* v. *United States, supra,* has overruled *West Seattle National Bank, supra,* and *Citizens Federal Savings & Loan, supra,* relied upon so heavily by the Tenth Circuit in the *Anders* case.

In any event, were the *Anders* issue to come again before the Tax Court, that Court would not be bound by the Tenth Circuit's reversal of its prior decision, unless the case originated in the Tenth Circuit. *Jack E. Golsen,* 54 T.C. 742 (1970); *Arthur L. Lawrence,* 27 T.C. 713 (1957). Even if appeal were to lie to the Tenth Circuit, the *Golsen* rule is only a rule of practicality to foster "efficient and harmonious judicial administration". It does not permit the Tax Court to avoid its judicial responsibility as a court

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30. *S. E. Evans, Inc.* v. *United States,* 317 F. Supp. 423 (W.D. Ark. Sept. 17, 1970) and *Bishop* v. *United States,* 324 F. Supp. 1105 (M.D. Ga. Jan. 7, 1971) merely parrot the language of *Commissioner* v. *Anders, supra,* and *Spitalny* v. *United States,* 430 F.2d 195 (9th Cir. July 29, 1970). If the Tenth Circuit had difficulty in rationalizing its conclusion in *Anders,* it was nothing compared to the ordeal of the Ninth Circuit in *Spitalny,* which found it necessary to "fictionalize" the question in this way:

> "We agree that the feed and supplies are 'property' under § 337(b) and, accordingly, that 'gain' realized on their sale shall not be recognized. The crucial question, however, is whether gain was realized." 430 F.2d at 198.

Logical enough to this point. But now the paradoxical words begin:

> "The assignment of a zero basis to expensed items is not in response to adjustments in valuation. It amounts, rather, to a present fictional conversion (*sic*) of that 'property' into a consumed item of expense. If the feed and supplies are to revert to 'property' they should be reconverted. They should not at the same time be property and still retain attributes of a fictional nonentity." *Ibid.*

Fiction, this may well be. *Tax law,* it is not!

of national jurisdiction. *Oddee Smith*, 55 T.C. 260 at 269 (1970).

The substantive question here presented is one of first impression in this Court. There are material issues of fact. Defendant is not entitled to judgment as a matter of law.

WHEREFORE, plaintiff prays that defendant's Motion for Summary Judgment herein be DENIED.

Respectfully submitted,

Harlow B. King
Attorney for Plaintiff

Of Counsel:
J. Glenn Hahn
Walter J. Kennedy

Appendix A

STATUTES AND REGULATIONS

Statutes:

Sec. 337 [1954 Code]. (a) GENERAL RULE—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) PROPERTY DEFINED—

(1) IN GENERAL—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) NONRECOGNITION WITH RESPECT TO INVENTORY IN CERTAIN CASES.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

Sec. 351 [1954 Code]. (a) GENERAL RULE.—No gain or loss shall be recognized if property is transferred to a corporation (including, in the case of transfers made on or before June 30, 1967, an investment company) by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

* * *

Sec. 1221 [1954 Code] For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * *

26 U.S.C. § 7482. Courts of review

(a) Jurisdiction.—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court except as provided in section 1254 of Title 28 of the United States Code in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

* * *

Regulation:

§ 1.162-3 Cost of materials

Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible

for the taxpayer to include in his expenses and to deduct from gross income the total cost of such supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method.

* * *

§ 1.337-3. Property Defined.—

(a) Except as provided in section 337(b) (2) and this section, the term "property" as used in section 337(a) and § 1.337-1 does not include, (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as "inventory"), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed in this paragraph, the term "property" includes all assets owned by a corporation.

(b) Except as provided in paragraph (c) of this section, if substantially all of the inventory is sold or exchanged to one person in one transaction, then for the purpose of section 337(a) the term "property" shall include:

(1) The inventory so sold or exchanged, and

(2) Installment obligations acquired in such sale or exchange. For this purpose, the term "substantially all" means substantially all of the inventory at the time of the sale and includes inventory subject to liabilities,

specific or otherwise. Section 337(b)(2) shall be inapplicable if the inventory so sold is replaced by like inventory, or by a new kind of inventory.

* * *

§ 1.446-1 General rule for methods of accounting

* * *

(c) Permissible methods—(1) In general. Subject to the provisions of paragraphs (a) and (b) of this section, a taxpayer may compute his taxable income under any of the following methods of accounting:

* * *

(iv) Combinations of the foregoing methods. (a) In accordance with the following rules, any combination of the foregoing methods of accounting will be permitted in connection with a trade or business if such combination clearly reflects income and is consistently used. Where a combination of methods of accounting includes any special methods, such as those referred to in subdivision (iii) of this subparagraph, the taxpayer must comply with the requirements relating to such special methods. A taxpayer using an accrual method of accounting with respect to purchases and sales may use the cash method in computing all other items of income and expense. However, a taxpayer who uses the cash method of accounting in computing gross income from his trade or business shall use the cash method in computing expenses of such trade or business. Similarly, a taxpayer who uses an accrual method of accounting in computing business expenses shall use an accrual method in computing items affecting gross income from his trade or business.

* * *

§ 1.471-1 Need for inventories

In order to reflect taxable income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include all finished or partly finished goods and, in the case of raw materials and supplies, only those which have been acquired for sale or which will physically become a part of merchandise intended for sale, in which class fall containers, such as kegs, bottles, and cases, whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein. Merchandise should be included in the inventory only if title thereto is vested in the taxpayer. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold (including containers), title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased (including containers), title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. (But see § 1.472-1.)

APPENDIX E-3

Reply Brief for the United States

IN THE UNITED STATES COURT OF CLAIMS

No. 35-71

D. B. ANDERS,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

REPLY BRIEF FOR THE UNITED STATES

Plaintiff opposes the Government's motion for summary judgment on two grounds: (1) that there are genuine issues of material fact, and (2) that, as a matter of law, the tax benefit rule is not applicable to a recovery of a prior deduction through a Section 337 liquidation sale. The following comments, in addition to those set forth in our initial brief, are submitted in reply.

Plaintiff characterizes the questions as to whether the rental items here involved were "property" within the meaning of Section 337(b) (either under Section 337(b)(1) or as "inventory" under Section 337(b)(2)) and whether there was a "sale or exchange" within the meaning of Section 337(a), as being disputed factual issues. We disagree. Plaintiff (Br. 4) admittedly does not dispute the facts set forth in defendant's initial brief; no further facts are sub-

mitted by plaintiff to disclose any basis for dispute; accordingly, the resolution of these issues becomes a question of law on the undisputed facts. See *United States* v. *Winthrop*, 417 F. 2d 905, 910 (C.A. 5, 1969). In any event, whether the rental items in question fit literally within the provisions of Section 337 of the 1954 Code is not determinative in plaintiff's favor. Assuming, arguendo, that they do, the question here is whether tax benefit principles nevertheless apply to require the recognition as ordinary income of the previously expensed cost of the rental items which was recovered in the liquidation sale. We wish to note that should this Court find that the defendant's legal contention is in error, plaintiff would accordingly be entitled to judgment in its behalf, though plaintiff's response to defendant's motion for summary judgment did not contain a cross-motion.

As our opening brief noted, the application of the tax benefit rule set forth by this Court in *Alice Phelan Sullivan Corp.* v. *United States*, 180 Ct. Cl. 659, 381 F. 2d 399 (1967),[1] to the recovery of a prior deduction through a Section 337 liquidation sale has been squarely upheld by the Ninth and Tenth Circuit Courts of Appeals. *Spitalny* v. *United States*, 430 F. 2d 195 (C.A. 9, 1970); *Commissioner* v. *Anders*, 414 F. 2d 1283 (C.A. 10, 1969), cert. denied, 396 U.S. 958 (1969). We add that the issue is now pending

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1. This Court said (180 Ct. Cl., p. 663, 381 F. 2d, pp. 401-402):

> Yet the principle is well engrained in our tax law that the return or recovery of property that was once the subject of an income tax deduction must be treated as income in the year of its recovery. (Citations omitted.) The only limitation upon that principle is the so-called "tax-benefit rule." This rule permits exclusion of the recovered item from income so long as its initial use as a deduction did not provide a tax saving. (Citations omitted.)

There is no showing here that the deduction of the cost of the rental items in question did not provide a tax saving.

before the Third Circuit Court of Appeals in *Connery* v. *United States* (No. 19,413), involving prepaid advertising expenses in a Section 337 liquidation, on the taxpayer's appeal from the District Court's decision. (*Connery* v. *United States*, 26 A.F.T.R. 2d 5123 (N.J., June 29, 1970).) The *Connery* case was argued before the Third Circuit on March 14, 1972.

Contrary to plaintiff's assertion (Br. 18, 19), *Spitalny* and *Anders* do not contravene the purpose of Section 337. Section 337 was designed to eliminate the distinction between *Court Holding Co.*[2] situations and *Cumberland Pub. Serv. Co.*[3] situations. See Bittker and Eustice, *Federal Income of Corporations and Shareholders* (2d ed.), pp. 402, 404 (fn. 96). The application of the tax benefit rule here is not involved with that distinction; in either situation (a sale by the corporation as in *Court Holding*, or a distribution to, and sale by, the shareholders as in *Cumberland Pub. Serv.*), we submit that the tax benefit rule would apply to cause corporate recognition of the recovery of the previously deducted cost of the rental items here involved. *Commissioner* v. *Anders*, *supra*, p. 1286; *Bishop* v. *United States*, 324 F. Supp. 1105, 1110-1111 (M.D. Ga., 1971).

Plaintiff maintains (Br. 22, 23) that the United States Supreme Court's decision in *Nash* v. *United States*, 398 U.S. 1 (1970), in effect overrules the holdings in *West Seattle National Bank of Seattle* v. *Commissioner*, 288 F. 2d 47 (C.A. 9, 1961), and *Citizens Federal S. & L. Assn. of Cleveland* v. *United States*, 154 Ct. Cl. 305, 290 F. 2d 932 (1961). Further, plaintiff maintains that *Nash* should be deemed to overrule the Tenth Circuit's decision in *Commissioner* v. *Anders*, *supra*. *Nash* involved the transfer of

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2. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945).

3. *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451 (1950).

partnership accounts receivable at net value (the face value of the amounts receivable less the amount of bad debt reserve) to several corporations in exchange for stock under Section 351 of the 1954 Code, and the Supreme Court held that although the partnership business had terminated and it had no "need" for the reserve (which had previously been the test for recognition as income of bad debt reserves under tax benefit principles), the tax benefit rule did not apply since the partnership received no gain as a result of the transaction and there was no "recovery" of the benefit of the bad debt reserve. *West Seattle National Bank* involved a liquidation sale under Section 337 of accounts receivable at face (not net) value, and the Ninth Circuit held under tax benefit principles that the taxpayer's bad debt reserve should be recognized as ordinary income and was not insulated from recognition under Section 337. Since there was a "recovery" in *West Seattle National Bank*, we submit that the result is unchanged by *Nash*. See *Bishop* v. *United States, supra* at 324 F. Supp., pp. 1111-1112, and *Citizens' Acceptance Corp.* v. *United States*, 320 F. Supp. 798 (Del., 1971). While the opinion in *Citizens Federal S. & L. Assn., supra*, does not disclose whether the federal insurance reserve there involved was "recovered" in the liquidation sale, in absence of which a different result might obtain under *Nash*, it is unnecessary to so determine here, since it is clear that in the instant action the previously expensed cost of the rental items was, in fact, recovered. Accordingly, we believe the decision in *Nash* confirms, rather than overrules, the rationale of *Spitalny* and *Anders*.

While the advantage gained through the full expensing of these items in one year is normally balanced in a going business by the lack of deduction therefor in the

following years, the effect of liquidation here (or of a sale without a Section 337 liquidation) is to destroy that balance, which is redressed by the application of the tax benefit rule. See *Spitalny* v. *United States, supra,* 430 F. 2d, p. 197.

CONCLUSION

The petition should be dismissed.

Respectfully submitted,

/s/ Scott P. Crampton
Scott P. Crampton,
Assistant Attorney General,
Philip R. Miller,
Joseph Kovner,
Kenneth R. Boiarsky,
Attorneys,
Department of Justice,
Washington, D.C. 20530

MARCH, 1972.